IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1312

DON E. WILLIAMS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Petitioner prays that a Writ of Certiorari issue to review the judgments of the United States Court of Appeals for the Seventh Circuit entered in the above case on December 16, 1975.

OPINIONS BELOW

The opinion of the United States Tax Court is reported at 62 T.C. No. 19. The opinion of the Court of Appeals for the Seventh Circuit is not yet officially reported.

JURISDICTION

The judgment of the Court of Appeals for the Seventh Circuit was made and entered on December 16, 1975 and copies thereof are appended to this petition. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

I. Whether the delivery by Don E. Williams Company, an accrual basis taxpayer, of a promissory note with a face value of $31,589.32 secured by an assignment by the President and Vice President of their interests in the Profit Sharing Trusts, an assignment by the President of his 4,180 shares of $10.00 par value common stock of the Don E. Williams Company and personally guaranteed by the President, Vice President and Secretary-Treasurer of Don E. Williams Company constituted the "payment" under 26 U.S.C. § 404 to the Profit Sharing Trust of Don E. Williams Company's $31,589.32 designated contribution to the Profit Sharing Trust for the year ended April 30, 1967.

II. Whether the delivery by Don E. Williams Company, an accrual basis taxpayer, of a promissory note with a face value of $34,333.26 secured by an assignment by the President and Vice President of their interests in the Profit Sharing Trusts, an assignment by the President of his 4,180 shares of $10.00 par value common stock of the Don E. Williams Company and personally guaranteed by the President, Vice President and Secretary-Treasurer of Don E. Williams Company constituted the "payment" under 26 U.S.C. § 404 to the Profit Sharing Trust of Don E. Williams Company's $34,333.26 designated contribution to the Profit Sharing Trust for the year ended April 30, 1968.

III. Whether the delivery by Don E. Williams Company, an accrual basis taxpayer, of a promissory note with a face value of $35,337.86 secured by an assign-

ment by the President and Vice President of their interests in the Profit Sharing Trusts, an assignment by the President of his 4,180 shares of $10.00 par value common stock of the Don E. Williams Company and personally guaranteed by the President, Vice President and Secretary-Treasurer of Don E. Williams Company constituted the payment under 26 U.S.C. § 404 to the Profit Sharing Trust of Don E. Williams Company's $35,337.86 designated contribution to the Profit Sharing Trust for the year ended April 30, 1969.

STATUTES, FEDERAL RULES, AND REGULATIONS INVOLVED

THE INTERNAL REVENUE CODE OF (1954), §§ 404(a)(3)(A) & (6), 26 U.S.C. §§ 404(a)

(3) Stock bonus and profit-sharing trusts:

(A) Limits on deductible contributions. In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the stock bonus or profit-sharing plan. . . .

(6) Taxpayers on accrual basis:

For purposes of paragraphs (1), (2), and (3), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

STATEMENT

This appeal arises out of a complaint brought by the Petitioner, Don E. Williams Company, (hereinafter "Dewco") against the Respondent, Commissioner of Internal Revenue (hereinafter "C.I.R."). In its complaint Petitioner asked for a redetermination of the deficiency set forth by the C.I.R. in his Notice of Deficiency dated May 25, 1971.

The deficiency, which Petitioner feels is in error, as determined by the C.I.R. is in income tax as follows and results from disallowance of tax deductions.

Fiscal Year Ending	Amount of Disallowance	Amount/Tax Assessed
April 30, 1967	$31,589.32	$15,162.87
April 30, 1968	$ 2,743.94	$ 1,360.64
April 30, 1969	$ 1,004.60	$ 530.42

The commissioner erroneously determined for fiscal year ending April 30, 1967, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $31,589.32, and within the "grace period" allowed an accrual basis taxpayer by § 404 (a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404 (a) of the Internal Revenue Code of 1954.

The commissioner erroneously determined for fiscal year ending April 30, 1968, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $34,333.26, within the "grace period" allowed an accrual

basis taxpayer by § 404 (a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404 (a) of the Internal Revenue Code of 1954.

The commissioner erroneously determined for fiscal year ending April 30, 1969, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $35,337.86, within the "grace period" allowed an accrual basis taxpayer by § 404 (a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404 (a) of the Internal Revenue Code of 1954.

The facts and exhibits were stipulated to by the parties and the case was submitted to the Tax Court of the United States.

Judgment was entered for the Respondent, with three judges dissenting, assessing deficiencies in income tax due from Petitioner as set forth above.

On appeal, the United States Court of Appeals for the Seventh Circuit affirmed, however, in doing so they declined to follow decisions of the Third, Ninth, and Tenth Circuits and also a district court decision in the Seventh Circuit.

REASONS FOR GRANTING THE WRIT

The decision below should be reviewed because it involves a direct conflict with decisions of the Courts of Appeals in the Third, Ninth and Tenth Circuits.[1] In those cases it was held that a taxpayer's note is payment within the meaning of § 404(a) of the Internal Revenue Code.

In the *Sachs* case, 208 Fed. 313 (C.A. 3, 1953), which dealt with two separate cases in which the taxpayer transferred its own demand note to the trustee of the pension fund, the Court in reversing the Tax Court stated at page 315:

> Payment or paid does not invariably mean in cash. . . . If a check is sufficient, we see no reason why a negotiable demand note payable at a bank is not likewise sufficient.

The Court in that case was more interested in the value of the notes. They felt it was more important to determine if something of value had been received.

In the *Time Oil Co.* case, 26 T.C. 1061 (1956), reversed, 258 F. 2d 237 (C.A. 9, 1958), in which the corporation delivered non-interest bearing demand notes to the trustee and later replaced the notes with stock, the court was asked to rule as to whether the delivery constituted payment and the year in which the deduction could be taken.

[1] See *Slaymaker Lock Co. v. Commissioner*, 18 T.C. 1001 (1952), reversed sub nom. *Sachs v. Commissioner*, 208 F.2d 313 (3rd Cir. 1953); *Time Oil Co. v. Commissioner*, 26 T.C. 1061 (1956) reversed 258 F.2d 237 (9th Cir. 1955); *Wasatch Chemical Co. v. Commissioner*, 37 T.C. 817 (1962), reversed 313 F.2d 893 (10th Cir. 1963).

The Court stated that delivery of the notes constituted payment by Time Oil Co. as of the delivery date. That date would determine the year of deductibility.

This line of reasoning has been expanded and clarified in *Wasatch Chemical Co.*, 37 T.C. 817 (1962), reversed, 313 F. 2d 843 (C.A. 10, 1963). The Court there stated at page 846:

> The authorities thus hold that payment does not mean payment in cash. In the case at bar upon delivery of petitioner's notes, payment was thereby made in the amount of the then value of these notes and in that amount was the equivalent of cash.

In *Wasatch, supra*, the issue was whether delivery of the company's unsecured, interest-bearing promissory notes with stated maturities constituted payment to allow them as deductions on the company's income tax return.

The Court addressed itself more to the issue of whether anything of value was delivered to the trustee and if so, what was the value.

The Appellate Court decision in the case at bar also conflicts with the decision in *Advance Construction Co., Inc. v. U.S.*, 356 F.Supp. 1267 (N.D. Ill. 1972) a Seventh Circuit district court case involving a suit for a tax refund. That court also held that a taxpayer's term promissory note was a proper form of contribution under § 404(a).

At the present time, Appellant is aware of three (3) other cases which are on appeal in various circuits in which the same issue is presented.[2] It has been over

[2] *Coastal Electric Corporation v. C.I.R. T.C.* Memo 1975-231; *Lancer Clothing Corporation v. C.I.R. T.C.* Memo 1975-180; *Patmon Young & Kirk Professional Corporation v. C.I.R. T.C.* Memo 1975-185.

twelve years since the *Wasatch* case, *supra*, was decided and it is apparent that taxpayers by their course of conduct have been relying on the decisions cited by Appellant. It should also be noted that since the *Wasatch* case, Congress has passed several major pieces of legislation dealing with the Internal Revenue Code without considering this question. However, in the Pension Reform Act of 1974, Congress did make a change which allows cash basis taxpayers to take a deduction for a contribution to a qualified plan if the contribution is made by the time the return is due. This put cash and accrual basis taxpayers on parity and in effect was a liberalization by Congress.[3] It is submitted that these changes support Appellant's position and the cases relied upon.

The Petitioner requests this court to exercise its unique jurisdictional powers in order to establish a reliable course of conduct for business and to alleviate the hardships and uncertainty caused by the current conflict between Circuits.

This court has not settled this question. The Appellate Court in its opinion and the Respondent in its brief relied on *Eckert v. Burnet*, 283 U.S. 140 (1931) and *Helvering v. Price*, 309 U.S. 409 (1940). However, these cases involved the giving of a note for a debt which was an already worthless debt. In addition the notes were due in the year following the claimed deduction, a situation not in accord with the facts in the case at bar where the Petitioner gave a demand note, in the year of the deduction.

The *Eckert* case stands for the proposition that acquisition of a worthless debt cannot be charged off so as

[3] Internal Revenue Code, Section 404 (a)(6), 1954.

to take advantage of a bad debt deduction. In *Price*, it was held that an ordinary loss is not sustained by a guarantor who gives the person guaranteed a personal note not payable within the taxable year. It is submitted that these two cases do not stand for the all-inclusive proposition that promissory notes are a mere promise to pay and not the equivalent of cash or property with a cash value.

The cases relied upon by this Petitioner dealt directly with what constitutes payment for tax deductibility purposes and held that payment in cash is not required. It is Petitioner's position that the cases relied upon by the Courts of the Third, Ninth and Tenth Circuits are relevant and controlling on all material issues in the case at bar.

Petitioner believes these cases have also presented another issue which has created a conflict which would be settled by the Supreme Court's review in this case. That is whether Federal Tax Law or the Uniform Commercial Code adopted by virtually every State is controlling in determining what constitutes payment. This issue has always appeared in the cases cited by Appellant and the circuits again have disagreed in their holdings. Since taxpayers are striving for uniformity, Appellant urges that this conflict is greatly in need of resolution.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

Opinion Of United States Tax Court

UNITED STATES TAX COURT

62 T. C. No. 19

DON E. WILLIAMS COMPANY,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 5946-71. — Filed May 14, 1974.

Petitioner contributed to its profit-sharing plan for three taxable years by issuing its demand, interest-bearing, promissory notes secured by pledges of its principal shareholders. Petitioner paid the notes in each of the succeeding years.

HELD: The promissory notes do not constitute "payment" required by section 404(a), I.R.C. 1954 and petitioner's deductions for the contributions are denied. *Logan Engineering Co.*, 12 T.C. 860 (1949), followed. *Sachs v. Commissioner*, 208 F. 2d 313 (C.A. 3, 1953); *Time Oil Co. v. Commissioner*, 258 F. 2d 237 (C.A. 9, 1958); and *Wasatch Chemical Co. v. Commissioner*, 313 F. 2d 843 (C.A. 10, 1963), not followed.

DONALD P. COONEY, for the petitioner.

ALLAN E. LAND, for the respondent.

OPINION

GOFFE, *Judge*: The Commissioner determined deficiencies in petitioner's income tax for the taxable years ended April 30, 1967; April 30, 1968; and April 30, 1969, in the amounts of $15,162.87; $1,360.64; and $530.42, respectively. The sole issue for decision is whether petitioner's promissory notes issued and delivered to the trustees of the trust for its profit-sharing plan constitute "payment" as required by section 404(a) of the Internal Revenue Code of 1954[1] thus entitling petitioner to deductions for the face amounts of the notes in the taxable years the notes were issued.

All of the facts have been stipulated. The stipulation of facts and exhibits are incorporated herein and adopted as our findings of fact. Only the facts necessary to an understanding of our opinion will be summarized herein.

Petitioner is a corporation organized under the laws of the State of Illinois with principal offices in Moline, Illinois. Its principal business activity is that of a manufacturers representative and wholesaler for factory tools and supplies.

Petitioner maintains its books and records and files its income tax returns on the accrual method of accounting using a fiscal year ending on April 30. Its returns for the taxable years before us were filed with the district director of internal revenue at Chicago, Illinois.

Petitioner has a profit-sharing plan which has been "qualified" since 1964. The trustees of the trust for the profit-sharing plan are its bank and the three principal shareholders of petitioner, who are also petitioner's officers.

Toward the end of each of its taxable years before us, the board of directors of petitioner authorized contributions to petitioner's profit-sharing plan and in the month immediately following the close of its taxable years petitioner delivered to the trustees its interest-bearing secured demand promissory notes for face amounts equal to the deductions claimed as employer contributions to the profit-sharing plan. Such amounts were accrued as liabilities on the books of petitioner at the close of each of the taxable years. The notes issued in 1967 and 1968 bore interest at the rate of 6 percent and the note issued in 1969 bore interest at the rate of 8 percent. Interest was payable at maturity. The officers and principal shareholders of petitioner, each as principals, jointly and severally, executed the notes as accommodation makers. The notes were secured solely by collateral owned by the accommodation makers and consisted of some stock in petitioner owned by one shareholder and the respective interests of two of the shareholders in the profit-sharing plan. The value of the collateral pledged by the two shareholders combined with the net worth of the third shareholder, who pledged nothing, exceeded the face amounts of the notes.

[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise noted.

Toward the end of each of its taxable years, petitioner paid each of the demand notes it had issued at the beginning of such year, together with the accrued interest thereon.

Petitioner deducted on its income tax returns the face amounts of the notes issued to the trustees of the profit-sharing plan and the Commissioner, in his statutory notice of deficiency, disallowed the deductions claimed, less the payments on the notes, on the grounds that the notes did not represent "payments" of the contributions within the meaning of section 404(a).

Section 404(a) and its predecessor, section 23(p) of the Internal Revenue Code of 1939, allow deductions for contributions *paid* by an employer to a qualified profit-sharing plan. Such contributions are, by the terms of section 404(a), not deductible as trade or business expenses under section 162 nor are they deductible as expenses for the production of income under section 212.

The deduction is allowable only if paid within the taxable year or, in the case of taxpayers on the accrual method of accounting, if paid within the time in which the income tax return of the employer is due to be filed. Sec. 1.404(a)-1(c),[2] Income Tax Regs. Other exceptions provide for situations not applicable here.

It is clear from the regulations that the contribution must be paid. The validity of the regulations is not challenged. Petitioner contends that the notes which it issued represent payment and respondent contends that notes do not represent payment for the purposes of section 404(a). Respondent relies upon four of our decisions and petitioner relies upon the decisions of three Courts of Appeals which reversed three of these cases.

The four cases involved, in chronological order, are *Logan Engineering Co.*, 12 T.C. 860 (1949); *Slaymaker Lock Co.*, 18 T.C. 1001 (1952), reversed sub nom. *Sachs v. Commissioner*, 208 F. 2d 313 (C.A. 3, 1953); *Time Oil Co.*, 26 T.C. 1061 (1956), reversed 258 F. 2d 237 (C.A. 9, 1958); and *Wasatch Chemical Co.*, 37 T.C. 817 (1962), reversed 313 F. 2d 843 (C.A. 10, 1963).

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[2] SEC. 1.404(a)-1

(c) Deductions under section 404(a) are generally allowable only for the year in which the contribution or compensation is paid, regardless of the fact that the taxpayer may make his returns on the accrual method of accounting. Exceptions are made in the case of overpayments as provided in paragraphs (1), (3), and (7) of section 404(a), and, as provided by section 404(a)(6), in the case of payments made by a taxpayer on the accrual method of accounting not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof). This latter provision is intended to permit a taxpayer on the accrual method to deduct such accrued contribution or compensation in the year of accrual, *provided payment is actually made* not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof) but this provision is not applicable unless during the taxable year on account of which the contribution is made the taxpayer incurs a liability to make the contribution, the amount of which is accruable under section 461 for such taxable year. See section 461 and the regulations thereunder. There is another exception in the case of certain taxpayers who are required to make additional contributions as a result of the Act of June 15, 1955 (Public Law 74, 84th Cong., 69 Stat. 134), and the regulations thereunder. [Emphasis added.]

An appeal in the instant case would lie in the Court of Appeals for the Seventh Circuit which has not considered the issue.

With all due respect to the Courts of Appeals for the Third, Ninth and Tenth Circuits, we decline to follow their decisions. Instead, we shall continue to follow our decisions, two of which were reviewed by the Court and not burdened with concurring or dissenting opinions. We do so because we continue to believe our decision was correct in the first case, *Logan Engineering, supra.* In that case, we construed section 23(p)(1) of the Internal Revenue Code of 1939, the predecessor of section 404(a) with which we are now concerned. We pointed out that the word "paid" used in the statute should be given its ordinary and usual meaning, "to liquidate in cash." *P. G. Lake, Inc., v. Commissioner*, 148 F. 2d 898 (C.A. 5, 1945); cf. *Commissioner v. Drovers Journal Pub. Co.*, 135 F. 2d 276, 278 (C.A. 7, 1943). However, delivery of a check satisfies the requirement of a liquidation in cash because it represents a conditional payment, but a promissory note is merely a negotiable promise to pay. *Estate of Modie J. Spiegel*, 12 T.C. 524 (1949).

We based our decision in *Logan Engineering, supra*, on legislative intent derived from the Report of the Ways and Means Committee on the Revenue Revision Act of 1948, 80th Cong. Rept. No. 2087, p. 13, wherein it stated, concerning section 23(p)(1)(E), that "An employer on the accrual basis of accounting may under existing law deduct contributions *actually paid* within the first 60 days of the subsequent year." (Emphasis added.) The report explained the Committee's recommendation to extend the time from one month to two months and 15 days within which an accrual basis employer could pay the contribution to the pension or profit-sharing plan after the close of the taxable year and yet be entitled to

deduct the contribution. *Sioux Tribe v. United States*, 316 U.S. 317, 329-330 (1942). The above-quoted language appears in the regulations set forth in footnote 2 which petitioner does not challenge as invalid.

We followed *Logan Engineering, supra*, in *Slaymaker, supra*, which was reversed sub nom., *Sachs v. Commissioner, supra*, by the Court of Appeals for the Third Circuit.

The Third Circuit bases its decision on *Miller v. Commissioner*, 164 F. 2d 268 (C.A. 3, 1947), which involved section 24(c)(1) of the Internal Revenue Code of 1939. That section covered the payment of expenses and interest following the close of a taxable year and is the predecessor of section 267 of the Internal Revenue Code of 1954.

Section 267, by its specific terms, applies to the disallowance of deductions for payments to related taxpayers; i.e., losses, interest, trade or business expenses deductible under section 162 and expenses incurred in the production of income under section 212. The deduction with which we are concerned is allowable only under section 404(a) and that section specifically precludes allowance of a deduction for such contributions under section 162 or section 212.

Because section 404(a) specifically prohibits deduction of the employer contribution under section 162 or section 212 and section 267, by its own terms, applies only to losses, taxes and deductions allowable under sections 162 and 212, section 267 cannot have any bearing upon "payment" under section 404(a). The Third Circuit in *Sachs, supra*, incorrectly drew an analogy between "payment" under section 404(a) and "payment" under other Code sections. "Payment" under section 404(a) should, instead, be interpreted independently in light of the intent of Congress as we explained above.

We also disagree with the Third Circuit when it suggests that there is little difference between a demand promissory note and a check drawn on a bank account.

The notes in *Sachs, supra*, were payable at a bank. In the instant case, the notes were not payable at a bank.

Illinois law, which applies here, embodies alternative B of section 3-121 of the Uniform Commercial Code which provides that a note "payable at a bank is not of itself an order or authorization of the bank to pay it." The analogy of a promissory note payable at a bank and a check as bank draft upon which the Third Circuit relied in *Sachs, supra*, therefore, cannot possibly apply in Illinois. The comparison of a bank draft or check and a promissory note *not* payable at a bank is even more far-fetched when the relationships of the parties are considered.

In the instant case, the officers and principal shareholders of the corporation provided the only security for the notes and they, together with a corporate trustee, were also the trustees who received the notes. In the case of a check drawn on the employer's bank account, however, an intermediate party is involved; i.e., the bank at which the check is presented for payment. If the intermediate party, the bank, is ignored so that the check is not cashed within a reasonable time, the check is no longer equivalent to money. *C. D. Fountain*, 59 T.C. 696, 702 (1973). Cf. *Randall N. Clark*, 58 T.C. 94 (1972).

Delivery of the note to the trust does not extinguish the obligation of the petitioner to contribute to the trust as is clearly demonstrated by section 3-802 of the U.C.C. adopted by Illinois which provides:

> Section 3-802. Effect of Instrument on Obligation for Which It Is Given.
>
> (1) Unless otherwise agreed where an instrument is taken for an underlying obligation
>
> (a) the obligation is pro tanto discharged if a bank is drawer, maker or acceptor of the instrument and there is no recourse on the instrument against the underlying obligor; and

(b) *in any other case the obligation is suspended pro tanto until the instrument is due or if it is payable on demand until its presentment.* If the instrument is dishonored action may be maintained on either the instrument or the obligation; discharge of the underlying obligor on the instrument also discharges him on the obligation. [Emphasis added.]

* * * * * * *

If the obligation upon which a note is given is suspended until presentment for payment as the U.C.C. quoted above indicates, it is difficult to see how it can be said that the contribution to the profit-sharing plan has been paid. Although the above-quoted provision of the U.C.C. was not applicable when we decided *Logan Engineering, supra, Modie J. Spiegel, supra, Slaymaker, supra, Time Oil, supra,* and *Wasatch Chemical, supra,* our holdings appear to us to be consistent with the U.C.C.

As we have observed before, Congress imposed the requirement of *payment* upon contributions to pension and profit-sharing plans even though such requirement is not imposed upon other deductions of accrual basis taxpayers. Congress, at the present time, is considering legislation to correct abuses in pension and profit-sharing plans. The Senate bill contemplates amendment of section 503(b) to further prohibit transactions between the trust and related parties, including the employer. Lending between the trust and the employer is prohibited by the terms of the Senate bill. The Report of the Senate Finance Committee accompanying S. 1179 contains the following:

> It is intended that prohibited loans include the acquisition by the trust of a debt instrument (such as a bond or note) which is an obligation of a party in interest. (However, the transition rules, described below, establish special rules regarding certain debt instruments held by the trust on August 21, 1973.) Similarly, the committee intends that it would be a prohibited transaction (in effect, a loan by the trust to the employer) if the employer funds his contributions to the trust with his own debt obligations. [S. Rept. No. 93-383, 93rd Cong., 1st Sess., p. 98 (1973)]

The provision proposed by the Senate is now a part of H.R. 2 which was passed by the Senate on March 4, 1974. The House version of H.R. 2 and the Senate version of H.R. 2 are presently pending before a conference.

Clearly the Senate intends the result our decisions have sought to achieve.

We followed our prior decisions in *Logan Engineering, supra,* and *Slaymaker, supra,* when we decided *Time Oil, supra.* The Court of Appeals for the Ninth Circuit reversed us in that case following the Third Circuit in *Sachs, supra,* and *Miller, supra.* The Ninth Circuit recognized the question to be close but observed that it was unnecessary to set up a conflict of circuits.

Our most recent case, *Wasatch Chemical, supra,* involved five-year unsecured promissory notes, not demand secured notes as we have here; therefore, we applied only our prior decision in *Logan Engineering, supra.* The Tenth Circuit reversed our decision and remanded the case for a determination of the fair market value of the promissory notes. It followed *Sachs, supra,* and *Time Oil, supra,* and concluded that term notes were equivalent to cash. It also pointed out that we recognized that the transfer of real property constituted "payment," citing *Colorado National Bank of Denver,* 30 T.C. 933 (1958). We have no quarrel with the proposition that the "payment" required by section 404(a) can be satisfied with a transfer of property, but a promissory note in the hands of the obligor is not property of the obligor for the purposes of section 404(a). We rejected such a proposition in *Slaymaker,* 18 T.C. 1001, 1006 (1952), and continue to believe it to be unsound.

Our prior decisions are sound and are based on Congressional intent now being reconfirmed by Congress and they are also in harmony with the U.C.C. provisions in Illinois.

We, therefore, continue to hold that the requirement of "payment" of section 404(a) is not satisfied by delivery of promissory notes of the employer seeking the deduction for the contribution to the pension or profit-sharing plan.

Reviewed by the Court.

DECISION WILL BE ENTERED FOR THE RESPONDENT.

IRWIN, J., dissenting: I respectfully disagree with the majority. In my opinion the delivery of petitioner's interest-bearing secured promissory notes payable on demand constituted payment for the purposes of section 404(a). Unlike the majority I would find cash equivalence. Cf. *Cowden v. Commissioner*, 289 F. 2d 20, 24 (C.A. 5, 1961).

I would also dispute the majority's finding for an additional reason. We have previously held that the delivery of property constitutes payment. *Colorado National Bank of Denver*, 30 T.C. 933 (1958). However, the majority summarily determines that since the notes are not property in the hands of the obligor they are not property. I suggest that the proper test of whether the notes constitute property should be directed to whether they are property in the hands of the holders, not the obligors. Cf. *Denver & Rio Grande Railroad Co. v. United States*, 318 F. 2d 922, 924 (Ct. Cl. 1963).

In determining that payment did not occur, the majority further relies upon the Uniform Commercial Code. Without considering the merits of their interpretation, I do not believe that the U.C.C. should be employed

to determine whether payment has occurred for Federal income tax purposes. Whether the delivery of the promissory notes constituted payment for the purposes of section 404(a) is a matter of Federal tax law, not state law. Cf. *Morgan v. Commissioner*, 309 U.S. 78 (1940).

It appears that there is implicit in the majority's reasoning a desire to protect the employees under the plan. However, section 404(a) only requires payment, not payment in cash. In my opinion other provisions of the Code provide the fund with sufficient protection. See, e.g., sections 401(a)(2) and 503(b). Furthermore, the legislative history of section 404(a) reveals only that Congress intended actual payment as a requisite to deduction, not payment in cash. See *Logan Engineering Co.*, 12 T.C. 860, 867 (1949); *Wasatch Chemical Company v. Commissioner*, 313 F. 2d 843, 845 (C.A. 10, 1963), for a discussion of the legislative history. While the majority relies upon *P. G. Lake, Inc. v. Commissioner*, 148 F. 2d 898, 900 (C.A. 5, 1945), for the proposition that the ordinary and usual meaning of the term "payment" is "to liquidate in cash," a review of the cases cited in *P. G. Lake* reveals little foundation for such a proposition. *P. G. Lake* involved constructive payment and the clear implication from the cases relied upon therein is that payment means to liquidate in cash or cash equivalent. See, e.g., *Helvering v. Price*, 309 U.S. 409 (1940). In addition, I believe that the narrow definition adopted by the majority is not in harmony with the widespread use of commercial paper and I, therefore, cannot subscribe to it.

Finally, while the delivery of one's own note as payment might, in substance, be viewed merely as a loan transaction, this factor should not necessarily affect the allowance of the deduction. It seems evident that a corporation may borrow from its pension fund and use the proceeds to meet its contribution requirements provided the transaction does not fall within the prohibitions of section 503. Viewing the instant situation in this light, respondent's proper course of action should be through section 503, not section 404(a). I can find no legislative support or other compelling reason to restrict the meaning of the term "payment" as the majority has done.

QUEALY, J., dissenting: In its majority opinion, the Court reaffirms its earlier decisions with respect to what constitutes payment within the meaning of section 404(a) notwithstanding that three of those decisions have been rejected by Courts of Appeals for the 3rd, 9th and 10th Circuits. See *Sachs v. Commissioner*, 208 F. 2d 313 (C.A. 3, 1953); *Time Oil Co. v. Commissioner*, 258 F. 2d 237 (C.A. 9, 1958); and *Wasatch Chemical Co. v. Commissioner*, 313 F. 2d 843 (C.A. 10, 1963).

More than 10 years have elapsed since the most recent of those cases, during which time the Congress has considered several major revisions of the internal revenue laws and numerous technical amendments without addressing itself to this question. As pointed out in the majority opinion, a restriction upon the use of obligations of the employer as payments to a qualified pension plan was finally incorporated in H.R. 2, different versions of which were passed by the House and the Senate in this the 93d Congress, which are presently pending before a House-Senate conference. Rather than conclude that this belated action on the part of the Congress warrants the reaffirmance by this Court of a position previously rejected by the three appellate courts, I would conclude the opposite.

Notwithstanding the concept that this Court has assumed the role of a "national court" in questions involving the internal revenue laws, we must recognize that the appellate courts are also entitled to make such determinations. At some stage, we must be willing to accept a reversal of our position, even though we may not be wholly convinced of our error. In this situation, I think that we have passed beyond that point. After three reversals and the lapse of more than 10 years, taxpayers should be entitled to rely upon the decisions of the appellate courts.

HALL, J., agrees with this dissent.

APPENDIX B

Opinion Of United States Court Of Appeals For The Seventh Circuit

No. 74-1812

DON E. WILLIAMS COMPANY,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Appeal from the Tax Court of the United States
Docket No. 5946-71
WILLIAM A. GOFFE, *Judge.*

ARGUED FEBRUARY 25, 1975 — DECIDED DECEMBER 16, 1975

Before FAIRCHILD, *Chief Judge,* and CUMMINGS and SPRECHER, *Circuit Judges.*

FAIRCHILD, *Chief Judge.* Don E. Williams Company appeals from a decision of the Tax Court. The parties stipulated to the facts, set forth in the Tax Court opinion, 62 T.C. 166 (1974). The Tax Court sustained the Commissioner's disallowance of income tax deductions claimed pursuant to §404(a) of the Internal Revenue Code of 1954, 26 U.S.C. §404(a), for contributions to a qualified employee profit-sharing plan.

The issue is whether an accrual taxpayer's delivery of its secured promissory note to the trustees of the plan constitutes "payment" within the meaning of §404(a)(6).

After §404(a)(3) authorizes deduction of contributions paid by an employer to a profit-sharing plan, within limitations as to amount, "In the taxable year when paid," §404(a)(6) provides:

> (6) *Taxpayers on accrual basis.*—For purposes of paragraphs (1), (2), and (3), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return of such taxable year (including extensions thereof).

Thus, while a cash basis taxpayer must make payment before the close of the taxable year in order to deduct a contribution, an accrual basis taxpayer is given a grace period extending beyond the close of the taxable year.

In the instant case, Williams Company, an accrual basis taxpayer, accrued on its books within the taxable year a liability for a contribution to a qualified employee profit-sharing fund. Within the time allowable for filing a return the company delivered its interest-bearing secured demand note to the trustees of the profit-sharing fund.[1] The note was secured by collateral consisting of stock in the company and the interests of two of the shareholders in the profit-sharing plan. The note was guaranteed by officers of the company. It was stipulated that the value of the collateral, combined with the net worth of one of the guarantors, exceeded the face value of the note.

The Tax Court sustained, with three judges dissenting, the Commissioner's determination that contributions made in the form of a taxpayer's promissory note did not qualify as "payment" under §404(a)(6). The majority of the court retained a position consistent with its earlier rulings, even in the face of reversals by several Courts of Appeals.[2] We affirm the Tax Court's decision.

---

[1] The Williams Company followed this procedure for the taxable years ending April 30, 1967; 1968; and 1969. The interest rates on the promissory notes were 6 percent, 6 percent and 8 percent, respectively.

[2] See *Logan Engineering Co. v. Commissioner*, 12 T.C. 860 (1949); *Slaymaker Lock Co. v. Commissioner*, 18 T.C. 1001 (1952), *reversed sub nom. Sachs v. Commissioner*, 208 F.2d 313 (3rd Cir. 1953); *Time Oil Co. v. Commissioner*, 26 T.C. 1061 (1956), *reversed*, 258 F.2d 237 (9th Cir. 1958); *Wasatch Chemical Co. v. Commissioner*, 37 T.C. 817 (1962), *reversed*, 313 F.2d [illegible] (10th Cir. 1963).

The Treasury Regulation interpreting §404(a) provides in part:

> §1.404(a)-1 *Contributions of an employer to an employees' trust or annuity plan compensation under a deferred payment plan; general rule.*
>
> * * *
>
> * * *
>
> * * *
>
> (c) Deductions under section 404(a) are generally allowable only for the year in which the contribution or compensation is paid regardless of the fact that the taxpayer may make his returns on the accrual method of accounting. . .
>
> * * *
>
> This latter provision is intended to permit a taxpayer on the accrual method to deduct such accrued contribution or compensation in the year of accrual, *provided payment is actually made* not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof), but this provision is not applicable unless, during the taxable year on account of which the contribution is made, the taxpayer incurs a liability to make the contribution, the amount of which is accruable under section 461 for such taxable year. See section 461 and the regulations thereunder. . . . (Emphasis added.)

We can see no difference in the way the statute and regulations treat the accrual basis and cash basis taxpayers for purposes of what constitutes "payment" except that the accrual taxpayer may make "payment" during the grace period if the liability to pay was incurred during the taxable year. As we interpret the statute, the grace period for accrual taxpayers does not change the type or nature of "payment" that is required. We are unable to justify accepting payment in the form of a promissory note for an accrual taxpayer when it seems clear that it would not be considered payment for the cash basis taxpayer.

The Supreme Court has stated that the issuance of a cash basis taxpayer's promissory note is not the equivalent of payment. In *Eckert* v. *Burnet*, 283 U.S. 140 (1931), where it was held that a cash basis taxpayer sustained

no loss in the year in which he gave his promissory note, the Court said:

> As happily stated by the Board of Tax Appeals, the petitioner 'merely exchanged his note under which he was primarily liable for the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value.' A deduction may be permissible in the taxable year in which the petitioner pays cash. 283 U.S. at 141, 142.

In *Helvering* v. *Price*, 309 U.S. 409 (1940), the Court held that a cash basis taxpayer was not entitled to a loss deduction where the taxpayer substituted his new note for an earlier one in discharge of his guaranty obligation. Relying on *Eckert*, the Court stated:

> We think that this decision [*Eckert*] is controlling in the instant case. As the return was on the cash basis, there could be no deduction in the year 1932, unless the substitution of respondent's note in that year constituted a payment in cash or its equivalent. There was no cash payment and under the doctrine of the *Eckert* case the *giving of the taxpayer's own note was not the equivalent of cash to entitle the taxpayer to the deduction.*
>
> Respondent urges that his note was secured, but the collateral was not payment. It was given to secure respondent's promise to pay, and if that promise to pay was not sufficient to warrant the deduction until the promise was made good by actual payment, the giving of security for performance did not transform the promise into the payment required to constitute a deductible loss in the taxable year. See *Jenkins* v. *Bitgood,* 101 F.2d 17, 19. 309 U.S. at 413, 414. (Emphasis added.)

This court, in *Cleaver* v. *Commissioner of Internal Revenue,* 158 F.2d 342 (7th Cir. 1946), *cert. denied,* 330 U.S. 849, adopted the reasoning in *Eckert* and *Price* in denying a cash basis taxpayer a deduction for interest payments. The taxpayer had merely agreed to pay the interest in the form of a promissory note. "[N]o cash payment had actually been made; and . . ., therefore, the deduction for interest paid was improper." 158 F.2d at 344.

We think the legislative history of §404(a) supports the conclusion that the payment requirement is not fulfilled by the delivery of a taxpayer's promissory note. The Ways and Means Committee Report on the Revenue Revision Act of 1948 states: "An employer on the accrual basis of accounting may under existing law deduct contributions *actually paid* within the first 60 days of the subsequent year." 80th Cong. Rep. N. 2087, p. 13. (Emphasis added.) We interpret the emphasis on "actually paid" to connote a liquid form of payment and not a promissory note which is in substance only another form of an obligation to pay.[3]

In accord with this interpretation, the Tax Court in *Logan Engineering Co.* v. *Commissioner,* 12 T.C. 860 (1949) stated that the word "paid" as used in section 23(p), the predecessor of §404(a), should be given its ordinary and usual meaning: "to liquidate in cash." Similarly, the Fifth Circuit in *P.G. Lake, Inc.* v. *Commissioner,* 148 F.2d 898 (5th Cir. 1945), stated:

> Where, as here, the definite word 'paid' is used in the statute we are not permitted by the theory of fiction to give to that word an indefinite meaning. . . . The ordinary and usual meaning of 'paid' is to liquidate a liability in cash. . . . 148 F.2d at 900.

Appellant cites cases from those circuits which have reversed the Tax Court on issues similar to the one under consideration. The Third Circuit in *Sachs* v. *Commissioner of Internal Revenue,* 208 F.2d 313 (3rd Cir. 1953), relying heavily on its prior decision in *Anthony P. Miller, Inc.* v. *Commissioner,* 164 F.2d 268 (3rd Cir. 1947), held that a solvent taxpayer's negotiable demand note delivered to a qualified pension fund constituted "payment" for purposes of §404(a). The *Miller* case dealt with the issue of whether a demand promissory note given by a corporation to one of its officers was "payment" of a salary within the meaning of section 29(c)(1), the predecessor of 26 U.S.C. §267. Besides relying on *Miller,* the court in *Sachs* reasoned that since the demand notes were payable at

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[3] Congress has with some frequency used the phrases "paid or incurred" and "paid or accrued" in those sections of the tax code where a cash or cash equivalent payment is not needed for an accrual basis taxpayer. See, for example, 26 U.S.C. §§164(a), 174(a)(1), 163(a), 175(a), 212, 216(a).

a bank and since the Commissioner of Internal Revenue had no objection to payments made in the form of a check, it "could see no reason why a negotiable demand note payable at a bank is not likewise sufficient." 208 F.2d at 315.

To the extent that the *Sachs* decision rests on the reasoning that the demand note was equivalent to a check, it may be distinguishable from the instant case as well as the other cases cited by appellant. Under Pennsylvania law, at issue in the *Sachs* case, the bank at which a note is payable on demand is to pay the note upon presentment out of available funds. Pa. Stat. Ann. Title 12A. §3-121. Uniform Commercial Code §3-121, alternative A. However, under Illinois law, as well as in the other jurisdictions cited by appellant, a note that states it is payable at a bank does not itself authorize the bank to make payment. Ill. Rev. Stat. Chp. 26, §3-121 (1973), Uniform Commercial Code §3-121, alternative B.

Time Oil Company v. *Commissioner of Internal Revenue*, 258 F.2d 237 (9th Cir. 1958), (reversing 26 T.C. 1061), also cited by appellant, deals with the same question of whether a taxpayer's note is "payment" within the meaning of section 404(a). The court conceded the issue to be a close one, but after reviewing the *Sachs* decision saw no reason to create a conflict among circuits and therefore held that the delivery of the note constituted payment.

The court in *Wasatch* v. *Commissioner,* 313 F.2d 843 (10th Cir. 1963), (*reversing* 37 T.C. 817), reached a similar conclusion. The issue in that case dealt with notes that had a stated maturity date as opposed to demand notes which were discussed in the *Sachs* and *Time Oil* decisions. The court found no difference in the principles involved between the two types of notes for purposes of section 404(a). The court said:

> Any note has a value at the time of delivery ranging from zero upwards which can be determined. This is the ordinary business consequence of the delivery of a promissory note, this is the value which here changed hands on delivery, and this is the value which was here 'paid' under Section 404 .... 313 F.2d at 847.

The appellant also relies on *Advance Construction Co., Inc.* v. *U.S.,* 356 F.Supp. 1267 (N.D. Ill. 1972), a district court case involving a suit for a tax refund. The court held that a taxpayer's term promissory note was a proper form of contribution under §404(a). The court reasoned that while cash is the "most undisputed manifestation" of payment, there also exists a whole spectrum of possible cash substitutes which could qualify as a "payment." The court said:

> . . . an obligation need not be satisfied in cash or in a form of cash so long as there is a transfer of something that has a current 'cash value'. Hence there are many substitutes for cash that can be considered as 'payment'. What is primary is not the form of cash payment but rather cash value. 356 F. Supp. at 1271.

The court concluded that a mere promise to pay without any physical evidence of that promise was too intangible to represent a transfer of "current cash value." However, if the promise was evidenced by a promissory note, then the court reasoned it could find "a physical transfer of something of value." 356 F.Supp. at 1271.

We respectfully decline to follow the Third, Ninth, and Tenth Circuit decisions and the district court decision cited by appellant.[4] The interpretation of "payment" as found in the Supreme Court decisions of *Eckert* and *Price* and our own decision in *Cleaver* seems to us to be the more defensible view in light of the legislative history and administrative construction. In view of the persistence of the Commissioner and the Tax Court in the face of several reversals, we do not treat this as a situation in which long standing and consistent interpretations of other circuits have merged into the meaning of the statute.

Practical considerations also favor a narrow construction of the "payment" requirement of §404(a). Although payment may be made in property other than cash, and evaluation of such property is necessary, an interpretation which excludes the giving of the taxpayer's promissory

[4] Because of the conflict, this opinion has been circulated to all judges of this court in regular active service. No judge has requested a vote on the question whether the adoption of the conflicting view should be reheard en banc.

note will substantially reduce the problem of evaluation for the Commissioner and the courts.[8]

We hold that the "payment" requirement of section 404(a) Internal Revenue Code is not fulfilled by the delivery of an accrual taxpayer's secured interest-bearing demand promissory note. The judgment appealed from is affirmed.

A true Copy:

Teste:

....

Clerk of the United States Court of Appeals for the Seventh Circuit

[8] Although the question presented is one of federal law, our holding is also consistent with the Uniform Commercial Code §3-802, adopted by Illinois, which provides in part that generally an instrument taken for an underlying obligation suspends the obligation until the instrument is due or, in the case of a demand note, until the note is presented.

APPENDIX C

Judgment Order Of United States Court Of Appeals For The Seventh Circuit

OPINION BY JUDGE FAIRCHILD

United States Court of Appeals For the Seventh Circuit

December 16, 1975

Before

HON. THOMAS E. FAIRCHILD, *Chief Judge*
HON. WALTER J. CUMMINGS, *Circuit Judge*
HON. ROBERT A. SPRECHER, *Circuit Judge*

No. 74-1812

DON E. WILLIAMS COMPANY,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Appeal from the Tax Court of the United States.
Docket No. 5946-71 — **William A. Goffe**, *Judge.*

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on May 15, 1974, be, and the same is hereby, affirmed, in accordance with the opinion of this Court filed this date.

APPENDIX

In The

Supreme Court of the United States

October Term, 1975

No. 75-1312

DON E. WILLIAMS COMPANY,
Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR CERTIORARI FILED MARCH 13, 1976
CERTIORARI GRANTED JUNE 7, 1976

TABLE OF CONTENTS

UNITED STATES TAX COURT
DOCKET ENTRIES

No. 5946-71

8-24-71—Petition Filed: Fee Paid Aug. 24, 1971. Served Aug. 25, 1971.

8-24-71—Request by Petr. for trial at Chicago, Ill. Granted Aug. 25, 1971, Served Aug. 25, 1971.

10-8-71—Answer filed by Resp. Served Oct. 12, 1971.

3-17-72—Notice Of Trial on June 19, 1972 at Chicago, Ill. Served Mar. 17, 1972.

6-19-72—Trial at Chicago, Ill. before Judge Goffe.
Stipulation of Facts filed (with att. exh.).
Original Briefs Due—Aug. 3, 1972.
Reply Briefs Due—Sept. 5, 1972.
Submitted To Judge Goffe.

7-11-72—Transcript of June 19, 1972 received.

7-31-72—Motion by Petr. for continuance of the date for filing Brief, to Aug. 18, 1972. Granted July 31, 1972, Served Aug. 1, 1972.

8-18-72—Brief for Respondent filed. Served Aug. 24, 1972.

8-18-72—Brief for Petitioner filed. Served Aug. 24, 1972.

9-18-72—Reply Brief for Petitioner filed. Served Sept. 22, 1972.

9-20-72—Reply Brief for Respondent filed. Served Sept. 22, 1972.

5-14-74—Opinion filed, Judge Goffe. Served May 14, 1974. Decision will be entered for the respondent.

5-15-74—Decision Entered, Judge Goffe. Served May 15, 1974.

5-30-74—Order, that the decision entered on May 15, 1974, is hereby vacated and set aside, and further, Order And Decision Entered, Judge Goffe. Served May 30, 1974.

Appellate Proceedings

8-12-74—Notice Of Appeal to U.S.C.A., 7th Cir., filed by Petr. Served Aug. 13, 1974.

8-13-74—Notice of Filing with copy of notice of appeal sent to Mr. Meade Whitaker, Chief Counsel. Served Aug. 13, 1974.

8-13-74—Notice, to parties, of assembling and date for transmission of the record. Served Aug. 13, 1974.

U.S. COURT OF APPEALS
SEVENTH CIRCUIT—DOCKET ENTRIES

No. 74-1812

11-1-74—Filed 0&2c of petitioner's motion for ext. of time to file brief and excerpts from record to 11/20/74 Svc.

11-4-74—Entered order that time for filing appellant's brief and appendix ext. only to 11/15/74.

11-15-74—Filed 15c of appellant's brief—Svc.

12-16-74—Filed 15c of appellee's brief—svc.

12-30-74—Filed 15c of appellant's reply brief—svc.

1-24-75—Entered order setting appeal for oral argument on 2/25/75 at 9:30 A.M. Oral argument limited to 20 min. per side.

2-25-75—Heard and taken under advisement.

12-16-75—Entered final judgment order Affirming.

12-16-75—Filed Opinion by Judge Fairchild.

12-29-75—Filed 0&1c of Appellee's Bill of Costs in the amount of $55.90.

1-7-76—Mandate Issued.

1-16-76—Filed Receipt of Tax Court for Mandate and Record.

3-19-76—Filed Notice of Filing Petition for Cert., Supreme Court #75-1312, dated 3/13/76.

TAX COURT OF THE UNITED STATES

DON E. WILLIAMS COMPANY, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 5946-71

PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (AP: CHI:CPG:LBM) dated May 25, 1971, and as a basis of its case alleges as follows:

1. The Petitioner is a corporation organized under the laws of the State of Illinois, with its principal office at 5402 Fourth Avenue, Moline, Illinois 61265. The returns for the periods here involved were filed with the District Director of Internal Revenue at Chicago, Illinois.

2. The notice of deficiency (a copy of which is attached and marked *Exhibit A*) was mailed to the Petitioner on May 25, 1971.

3. The deficiency as determined by the Commissioner is in income tax as follows:

Fiscal Year Ending	*Amount of Tax*
April 30, 1967	$ 15,162.87
April 30, 1968	1,360.64
April 30, 1969	530.42
Total Amount in dispute	$ 17,053.93

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

a. The Commissioner erroneously determined for fiscal year ending April 30, 1967 that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $31,589.32, within the "grace period" allowed an accrual basis Taxpayer by §404(a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of §404(a) of the Internal Revenue Code of 1954.

b. The Commissioner erroneously determined for fiscal year ending April 30, 1968 that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $34,333.26, within the "grace period" allowed an accrual basis Taxpayer by §404(a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of §404(a) of the Internal Revenue Code of 1954.

c. The Commissioner erroneously determined for fiscal year ending April 30, 1969 that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $35,337.86, within the "grace period" allowed an accrual basis Taxpayer by §404(a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of §404(a) of the Internal Revenue Code of 1954.

d. The Commissioner erred in disallowing as a deduction from gross income the amount of $31,589.32 for fiscal year ending April 30, 1967 claimed as a deduction by Petitioner on its return for a profit sharing contribution expense.

e. The Commissioner erred in disallowing as a deduction from gross income the amount of $2,743.94 for fiscal year ending April 30, 1968 claimed as a deduction by Petitioner on its return for a profit sharing contribution expense.

f. The Commissioner erred in disallowing as a deduction from gross income the amount of $1,004.60 for fiscal year ending April 30, 1969 claimed as a deduction by Petitioner on its return for a profit sharing contribution expense.

g. The Commissioner erred in determining a deficiency against Petitioner.

5. The facts upon which the Petitioner relies as the basis of this case are as follows:

a. The Petitioner kept its books of account and prepared its income tax returns for fiscal years ending April 30, 1967, April 30, 1968 and April 30, 1969 on the accrual basis of accounting.

b. Prior to April 30, 1967 the Board of Directors of the Petitioner incurred a liability for a profit sharing contribution to the Don E. Williams Company Profit Sharing Trust in the amount of $31,589.32 and accrued such amount as an expense on its books of account.

c. Prior to July 15, 1967 the Petitioner delivered its secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $31,589.32 to the Don E. Williams Company Profit Sharing Trust in payment of its fiscal year ending April 30, 1967 profit sharing contribution.

d. Prior to April 30, 1968 the Board of Directors of the Petitioner incurred a liability for a profit sharing contribution to the Don E. Williams Company Profit Sharing Trust in the amount of $34,333.26 and accrued such amount as an expense on its books of account.

e. Prior to July 15, 1968 the Petitioner delivered its secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $34,333.26 to the Don E. Williams Company Profit Sharing Trust in payment of its fiscal year ending April 30, 1968 profit sharing contribution.

f. Prior to April 30, 1969 the Board of Directors of the Petitioner incurred a liability for a profit sharing contribution to the Don E. Williams Company Profit Sharing Trust in the amount of $35,337.86 and accrued such amount as an expense on its books of account.

g. Prior to July 15, 1969 the Petitioner delivered its secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $35,337.86 to the Don E. Williams Company Profit Sharing Trust in payment of its fiscal year ending April 30, 1969 profit sharing contribution.

Wherefore, the Petitioner prays that this Court may try this case and determine:

a. That the Petitioner is entitled to additional deductions for profit sharing contributions as above claimed;

b. That there is no deficiency of income tax due by Petitioner for the fiscal years ended April 30, 1967, April 30, 1968 and April 30, 1969.

and give such other and proper relief as in the premises the Court may deem fit and proper.

/s/ D. P. Cooney
Counsel for Petitioner
P.O. Box 755
Dubuque, Iowa 52001

VERIFICATION OF PETITION

State of Illinois
County of Rock Island—ss:

Joseph W. Phillips, Jr., being duly sworn, says that he is the Executive Vice President of the Don E. Williams Company, the Petitioner above named, and as such is duly authorized to verify the foregoing petition; that he has read the foregoing Petition and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be on information and belief, and that those he believes to be true.

/s/ Joseph W. Phillips, Jr.

Subscribed and sworn to before me this 20 day of August, 1971 at Moline, Illinois.

/s/ Henry A. Gaull
Notary Public in and for
(Seal) Rock Island County, Illinois.

My commission expires the 1st day of June, 1975.

Department of the Treasury—
Internal Revenue Service

EXHIBIT A

Don E. Williams Company
5402 Fourth Avenue
Moline, Illinois 61265

Tax Year Ended	*Deficiency*
April 30, 1967	$15,162.87
April 30, 1968	$ 1,360.64
April 30, 1969	$ 530.42

Gentlemen:

This letter is to notify you—as required by law—that we have determined the income tax deficiencies shown above. I regret we have been unable to reach a satisfactory agreement in your case. The enclosed statement shows how the deficiencies were computed.

If you do not intend to contest this determination in the United States Tax Court, please sign and return the enclosed waiver form. This will permit an early assessment of the deficiencies and limit the accumulation of interest. The enclosed self-addressed envelope is for your convenience.

If you decide not to sign and return the waiver, the law requires that after 90 days from the date of mailing this letter (150 days if this letter is addressed to you outside the United States and the District of Columbia) we assess and bill you for the deficiencies. However, if within the time stated you contest this determination by filing a petition with the United States Tax Court, Box 70, Washington, D.C. 20044, we may not assess any deficiencies and bill you until after the Tax Court has decided your case. You may obtain a copy of the rules for filing a petition by writing to the Clerk of the Tax Court at the Court's Washington, D.C. address.

If you intend to file a petition with the United States Tax Court, you must do so within the time stated above (90 or 150 days, as the case may be); this period is fixed by law, and the Court cannot consider your case if your petition is filed late.

Under section 7463 of the Internal Revenue Code, the United States Tax Court has a simplified procedure for handling cases where the disputed portion of the deficiency does not exceed $1,000 for any one taxable year. You may obtain information on this special procedure, as well as a copy of the rules for filing a petition with the Tax Court,

by writing to the Clerk of the Tax Court at the Court's Washington, D.C. address.

Sincerely yours,
Randolph W. Thrower
Commissioner

By /s/ Bernard H. Waklen
Associate Chief
Appellate Branch Office
Midwest Region

Enclosures:
Waiver, Form 870
Statement
Envelope

Department of the Treasury—
Internal Revenue Service

WAIVER OF RESTRICTIONS ON ASSESSMENT AND COLLECTION OF DEFICIENCY IN TAX AND ACCEPTANCE OF OVERASSESSMENT

Pursuant to section 6213(d) of the Internal Revenue Code of 1954, or corresponding provisions of prior internal revenue laws, the undersigned waives the restrictions provided in section 6213(a) of the Internal Revenue Code of 1954 or corresponding provisions of prior internal revenue laws, and consents to the assessment and collection of the following deficiencies with interest as provided by law. The undersigned also accepts the following overassessments as correct:

Deficiencies

Year ended	*Kind of Tax*	*Amount of Tax*
April 30, 1967	Income	$15,162.87
April 30, 1968	Income	1,360.64
April 30, 1969	Income	530.42

Name and Address of Taxpayer(s)
(Number, street, city or town, State, ZIP Code)

Don E. Williams Company
5402 Fourth Avenue
Moline, Illinois 61265

DEPARTMENT OF THE TREASURY—
INTERNAL REVENUE SERVICE

STATUTORY NOTICE STATEMENT

Don E. Williams Company
5402 Fourth Avenue
Moline, Illinois 61265

Kind of Tax

Income

Taxable Year Ended	*Deficiency*
April 30, 1967	$15,162.87
April 30, 1968	1,360.64
April 30, 1969	530.42

☒ Copy to Authorized Representative:

Mr. D. P. Cooney
Arcade Building—Room 218
P.O. Box 755
Dubuque, Iowa 52001

DEPARTMENT OF THE TREASURY—
INTERNAL REVENUE SERVICE

CORPORATION INCOME TAX

Name			
Don E. Williams Company	4/30/67	4/30/68	4/30/69
Taxable Income As Shown In:			
☒ Return As Filed			
☐ Preliminary Letter Dated			
☐ Statutory Notice Dated	$ 55,947.29	$ 85,984.74	$ 58,756.91
Increases (Decreases) In Income (See attached explanation of items)			
(a) Deductions for profit sharing plan	31,589.32	2,743.94	1,004.60
Taxable Income as Revised	87,536.61	88,728.68	59,761.51
A. Less: Excess Of Net Long-Term Capital Gain Over Net Short-Term Capital Loss *(Alternative tax computation)*			2,000.00
B. Income Subject To Tax	87,536.61	88,728.68	57,761.51
C. Partial Tax For Income On Line B	35,517.57	36,089.77	21,225.52
D. 25% Of Amount Shown On Line A *(Alternative tax computation)*			500.00
E. Tax Surcharge		1,193.13	2,172.55

F. Other Taxes			
G. Subtotal *(Lines C, D, E and F)*	35,517.57	37,282.90	23,898.07
H. Tax Credits Per return	350.85	124.72	106.64
I. Income Tax Liability *(Line G less Line H)*	35,166.72	37,158.18	23,791.43
J. Income Tax Liability Shown On Return And Additional Assessment (Overassessment) Per return	20,003.85	35,797.54	23,261.01
K. Deficiency (Overassessment)	$ 15,162.87	$ 1,360.64	$ 530.42

EXPLANATION OF ITEMS

(a) It is determined that the delivery by you of interest-bearing demand notes to the Trustees of the Don E. Williams Company Profit Sharing Trust does not represent payment within the meaning of section 404(a) of the Internal Revenue Code. It is therefore determined that you are not entitled to profit sharing contribution deductions in excess of cash payments made in each taxable year as shown below:

	F 4-30-67	F 4-30-68	F 4-30-69
Deduction claimed	$31,589.32	$34,333.26	$35,337.86
Cash payments	-0-	31,589.32	34,333.26
Amount disallowed	$31,589.32	$ 2,743.94	$ 1,004.60

Accordingly, your taxable income for each year is increased by the respective disallowed amounts above.

UNITED STATES TAX COURT

(Title omitted in printing)

ANSWER

The Respondent, in answer to the petition filed in the above-entitled case, admits and denies as follows:

1., 2. and 3. Admits the allegations contained in paragraphs 1., 2. and 3. of the petition.

4. a. through g., inclusive. Denies the Commissioner erred as alleged in subparagraphs a. through g., inclusive, of paragraph 4. of the petition, or in any manner.

5. a. Admits the allegations contained in subparagraph a. of paragraph 5. of the petition.

b. through g., inclusive. Denies the allegations contained in subparagraphs b. through g., inclusive, of paragraph 5. of the petition.

6. Denies generally each and every allegation of the petion not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the deficiencies determined by the respondent be in all respects approved.

/s/ K. Martin Worthy
Chief Counsel
Internal Revenue Service

STIPULATION OF FACTS

The parties stipulate that for the purpose of this case the following facts and attached exhibits may be accepted as true, subject to the rights of the parties to introduce other and further evidence not inconsistent with this stipulation and to object, at the time of trial, to any or all portions of this stipulation and attached exhibits as they may consider irrelevant or immaterial.

1. The petitioner is a corporation organized under the laws of the State of Illinois, with its principal office at 5402 Fourth Avenue, Moline, Illinois, 61265.

2. At all times material hereto, the petitioner kept its books of account and prepared its U.S. Corporation Income Tax Returns, Forms 1120, and supporting schedules, using an accrual method of accounting and a fiscal year ending April 30th.

3. At all times material hereto, the officers of the Don E. Williams Company and their percentage ownership of the outstanding capital stock ($10.00 par value common stock) of the Petitioner were as follows:

Officer	Office	Percentage of Common Stock Owned
Don E. Williams, Jr.	President	87.08%
Joseph W. Phillips, Jr.	Vice President	4.17%
Alice R. Williams	Secretary-Treasurer	4.58%

4. The Petitioner filed its U.S. Corporation Income Tax Return, Form 1120, and supporting schedules for fiscal year ending April 30, 1967 with the District Director of Internal Revenue at Chicago, Illinois; a copy of which is attached hereto and marked Exhibit 1-A.

5. The Petitioner filed its U.S. Corporation Income Tax Return, Form 1120, and supporting schedules for fiscal year ending April 30, 1968 with the District Director of Internal Revenue at Chicago, Illinois; a copy of which is attached hereto and marked Exhibit 2-B.

6. The Petitioner filed its U.S. Corporation Income Tax Return, Form 1120, and supporting schedules for fiscal year ending April 30, 1969 with the District Director of Internal Revenue at Chicago, Illinois; a copy of which is attached hereto and marked Exhibit 3-C.

7. On November 27, 1963 the Board of Directors of petitioner adopted the Don E. Williams Company Profit Sharing Plan and established as a part thereof, the Don E. Williams Profit Sharing Trust.

8. On August 24, 1964 the District Director of Internal Revenue at Chicago, Illinois issued a "Determination Letter" approving the Don E. Williams Company Profit Sharing Plan and Trust, a copy of which is attached hereto as petitioner's Exhibit 4.

9. At all times material hereto, the Trustees of the Don E. Williams Company Profit Sharing Trust were as follows:

Name	Title
Don E. Williams, Jr.	Individual trustee
Joseph W. Phillips, Jr.	Individual trustee
Alice R. Williams	Individual trustee
First National Bank of Moline	Corporate trustee

10. On the 28th day of April, 1967 the Board of Directors of the Petitioner incurred a liability for a profit sharing contribution to the Don E. Williams Company Profit

Sharing Trust in the amount of $31,589.32 and accrued such amount as an expense on its books of account for fiscal year ending April 30, 1967.

11. On the 26th day of May, 1967 the Petitioner delivered to the Trustees of the Don E. Williams Company Profit Sharing Trust, as and for payment of its profit sharing contribution for the fiscal year ending April 30, 1967, the following documents:

a. A Collateral Promissory Note dated May 26, 1967 of the Petitioner in the amount of $31,589.32, a copy of which is attached hereto as petitioner's Exhibit 5;

b. An Assignment dated May 26, 1967 of Don E. Williams, Jr. of all his right, title and interest in and to his 4,180 shares of the $10.00 par value common stock of the Don E. Williams Company, a copy of which is attached hereto as petitioner's Exhibit 6;

c. An Assignment dated May 26, 1967 of Don E. Williams, Jr. of all his right, title and interest in and to his share of the Don E. Williams Company Profit Sharing Trust, a copy of which is attached hereto as petitioner's Exhibit 7;

d. An Assignment dated May 26, 1967 of Joseph W. Phillips, Jr. of all his right, title and interest in and to his share of the Don E. Williams Company Profit Sharing Trust, a copy of which is attached hereto as petitioner's Exhibit 8.

12. Pursuant to the books of account of the Don E. Williams Profit Sharing Trust, the fair market value of the share of Don E. Williams, Jr. in the Don E. Williams Company Profit Sharing Trust as of April 30, 1967 was in excess of $27,000.00.

13. Pursuant to the books of account of the Don E. Williams Profit Sharing Trust, the fair market value of the share of Joseph W. Phillips, Jr. in the Don E. Williams Company Profit Sharing Trust as of April 30, 1967 was in excess of $12,000.00.

14. As of April 30, 1967, the fair market value of the net assets of Alice R. Williams exceeded $120,000.00.

15. On the 4th day of April, 1968 the Petitioner delivered its check in the amount of $33,353.03 to the Trustees of the Don E. Williams Company Profit Sharing Trust as and for full and complete payment of its liability on its Collateral Promissory Note dated May 26, 1967 of $31,589.32 and interest accrued thereon of $1,763.71.

16. On the 26th day of April, 1968 the Board of Directors of the Petitioner incurred a liability for a profit sharing contribution to the Don E. Williams Company Profit Sharing Trust in the amount of $34,333.26 and accrued such amount as an expense on its books of account for the fiscal year ending April 30, 1968.

17. On the 24th day of May, 1968 the Petitioner delivered to the Trustees of the Don E. Williams Company Profit Sharing Trust, as and for payment of its profit sharing contribution for the fiscal year ending April 30, 1968, the following documents:

a. A Collateral Promissory Note dated May 24, 1968 of the Petitioner in the amount of $34,333.26, a copy of which is attached hereto as petitioner's Exhibit 9;

b. An Assignment dated May 24, 1968 of Don E. Williams, Jr. of all his right, title and interest in and to his 4,180 shares of the $10.00 par value common

stock of the Don E. Williams Company, a copy of which is attached hereto as petitioner's Exhibit 10;

c. An Assignment dated May 24, 1968 of Don E. Williams, Jr. of all his right, title and interest in and to his share of the Don E. Williams Company Profit Sharing Trust, a copy of which is attached hereto as petitioner's Exhibit 11; and

d. An Assignment dated May 24, 1968 of Joseph W. Phillips, Jr. of all his right, title and interest in and to his share of the Don E. Williams Company Profit Sharing Trust, a copy of which is attached hereto as petitioner's Exhibit 12.

18. Pursuant to the books of account of the Don E. Williams Profit Sharing Trust, the fair market value of the share of Don E. Williams, Jr. in the Don E. Williams Company Profit Sharing Trust as of April 30, 1968 was in excess of $38,000.00.

19. Pursuant to the books of account of the Don E. Williams Profit Sharing Trust, the fair market value of the share of Joseph W. Phillips, Jr. in the Don E. Williams Company Profit Sharing Trust as of April 30, 1968 was in excess of $17,000.00.

20. As of April 30, 1968, the fair market value of the net assets of Alice R. Williams exceeded $120,000.00.

21. On the 28th day of April, 1969 the Petitioner delivered its check in the amount of $36,381.81 to the Trustees of the Don E. Williams Company Profit Sharing Trust as and for full and complete payment of its liability on its Collateral Promissory Note dated May 24, 1968 of $34,-333.26 and interest accrued thereon of $2,048.55.

22. On the 25th day of April, 1969 the Board of Directors of the Petitioner incurred a liability for a profit sharing contribution to the Don E. Williams Company Profit Sharing Trust in the amount of $35,337.86 and accrued such amount as an expense on its books of account for fiscal year ending April 30, 1969.

23. On the 30th day of May, 1969 the Petitioner delivered to the Trustees of the Don E. Williams Company Profit Sharing Trust, as and for payment of its profit sharing contribution for the fiscal year ending April 30, 1969, the following documents:

a. A Collateral Promissory Note dated May 30, 1969 of the Petitioner in the amount of $35,337.86, a copy of which is attached hereto as petitioner's Exhibit 13;

b. An Assignment dated May 30, 1969 of Don E. Williams, Jr. of all his right, title and interest in and to his 4,180 shares of the $10.00 par value common stock of the Don E. Williams Company, a copy of which is attached hereto as petitioner's Exhibit 14;

c. An Assignment dated May 30, 1969 of Don E. Williams, Jr. of all his right, title and interest in and to his share of the Don E. Williams Company Profit Sharing Trust, a copy of which is attached hereto as petitioner's Exhibit 15; and

d. An Assignment dated May 30, 1969 of Joseph W. Phillips, Jr. of all his right, title and interest in and to his share of the Don E. Williams Company Profit Sharing Trust, a copy of which is attached hereto as petitioner's Exhibit 16.

24. Pursuant to the books of account of the Don E. Williams Profit Sharing Trust, the fair market value of the

share of Don E. Williams, Jr. in the Don E. Williams Company Profit Sharing Trust as of April 30, 1969 was in excess of $50,000.00.

25. Pursuant to the books of account of the Don E. Williams Profit Sharing Trust, the fair market value of the share of Joseph W. Phillips, Jr. in the Don E. Williams Company Profit Sharing Trust as of April 30, 1969 was in excess of $22,000.00.

26. As of April 30, 1969, the fair market value of the net assets of Alice R. Williams exceeded $120,000.00.

27. On the 31st day of March, 1970 the Petitioner delivered its check in the amount of $37,929.31 to the Trustees of the Don E. Williams Company Profit Sharing Trust as and for full and complete payment of its liability on its Collateral Promissory Note dated May 30, 1969 of $35,337.86 and interest accrued thereon of $2,591.45.

/s/ D. P. Cooney
Counsel for Petitioner

/s/ Lee H. Henkel, Jr.
Chief Counsel
Internal Revenue Service

EXHIBIT 5

COLLATERAL PROMISSORY NOTE

For Value Received, the Don E. Williams Company, an Illinois corporation with its registered office located in Moline, Illinois, as Maker, Don E. Williams, Jr. of East Moline, Illinois, as an Accommodation Maker, Alice R. Williams, of Moline, Illinois, as an Accommodation Maker, Joseph W. Phillips, Jr., of Rock Island, Illinois, as an Accommodation Maker (hereinafter referred to collective-

ly as "Makers"), each as principal, jointly and severally, promise to pay to the order of the Don E. Williams Company Profit Sharing Trust, at Moline, Illinois, On Demand, the sum of Thirty-One Thousand Five Hundred Eighty-Nine Dollars and Thirty-Two Cents ($31,589.32) with interest from May 1, 1967 at the rate of six percent (6%) per annum, payable at maturity.

The Makers hereof shall have the right and privilege at their option of making such prepayments of principal and interest at such time or times as they may in their discretion determine.

Any interest or principal not paid when due shall bear interest at the rate of seven percent (7%) per annum.

It is stipulated, that in any suit brought for the collection of this *Collateral Promissory Note,* a reasonable attorney's fee shall be allowed and taxed with the costs in such suit.

Don E. Williams, Jr., as and for collateral security for this promissory note, hereby deposits with the Don E. Williams Company Profit Sharing Trust the following; to-wit:

(a). certificates No. 11 and 15 for four thousand one hundred eighty (4,180) shares of the Ten Dollars ($10.00) par value common stock of Don E. Williams Company, together with an appropriate *Assignment;* and,

(b). an *Assignment* of all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust.

Joseph W. Phillips, Jr., as and for collateral security for this promissory note, hereby deposits with the Don E. Williams Profit Sharing Trust an *Assignment* of all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust.

The obligation evidenced by this note, and by any extensions or renewals thereof in whole or in part, are included in the expression "such liabilities" as hereinafter used.

The Makers agree to deliver to the Trust additional securities to its satisfaction, on demand, should the market value of any of the securities at any time held hereunder decline, or should any of such securities for other reasons be deemed unsatisfactory to the Trust.

On the nonperformance of any of the promises herein contained, or upon the nonpayment of any of such liabilities at maturity, or in the case of the failure of the Makers to meet at maturity any liability of any of the Makers, either to the Trust or to any other party, or upon the failure of the Makers forthwith to furnish additional security to the satisfaction of the Trust as above provided, or upon the death, dissolution, termination of existence, declared insolvency or failure in business of, or appointment of a receiver for, or commission of any act of bankruptcy by, any of the Makers, or the entry of any judgment against any of the Makers, or a levy under a writ of attachment upon the credit or property of any of the Makers with the Trust, or in case any petition in bankruptcy shall be filed by or against any of the Makers, or any proceedings in bankruptcy or under any acts of Congress of other governmental authority relating to the relief of debtors should be commenced for the relief or readjustments of any indebtedness of any of the Makers, either through reorganization, composition, extension, or otherwise, all such liabilities of the Makers shall, at the option of the Trust, immediately mature and become forthwith due and payable, without remand or notice. In such event, full power and authority are hereby given the Trust to sell, assign, and deliver the whole or any part of such collateral at public or private sale, at such terms as it may deem best, without remand, advertisement, or notice of any kind, all of which are hereby expressly waived. If any such collateral is disposed of at private sale, the Trust shall be relieved from all liability or claim for inadequacy of price. At any such sale, the Trust may itself purchase the whole or any part of such collateral, free from any right of redemption on the part of any of the Makers, which is hereby waived and released.

In case of sale for any cause, or of receipt of any payments of principal or income on account of any of such collateral, the Trust may apply the proceeds of the sale or sales so made or the payments so received to pay any of such liabilities to the Trust, as the Trust or any one of its Trustees shall deem proper, returning the surplus, if any, to the appropriate Maker.

Notwithstanding the holding by the Trust of such collateral for the payment of such liabilities, or any sale, exchange, enforcement, collection of, realization upon, or compromise or settlement, actual or attempted, with reference to any of such collateral, the Makers shall be and remain liable for the payment in full of all such liabilities, except only to the extent that such liabilities, or any part thereof, shall be reduced by payment, or actual application thereon by the Trust of such collateral or the proceeds thereof.

The Trust shall not be liable for failure to collect, or demand payment of, or protest, or give notice of nonpayment of, such collateral, or any part thereof, or for any delay in so doing, nor shall the Trust be under obligation to take any action whatever in regard to such collateral or any part thereof.

The collateral may from time to time, by mutual consent, be exchanged for other property, which shall be held by the Trust subject to all the terms of this note. All the terms hereof shall apply to all notes given in extension or renewal of this note, and to all substituted and additional collateral.

The Trust may transfer this note, and may deliver and transfer the collateral or any part thereof then held, to any transferee, who shall thereupon become vested with all the rights of the Trust to the collateral so transferred, and the Trust shall thereafter be forever relieved and fully discharged from all liability or responsibility under this note as to such collateral or as indorser or otherwise; but as respects any collateral not so transferred the Trust shall retain all rights hereby given.

No delay on the part of any holder hereof in exercising any power or right hereunder shall operate as a waiver of any power or right; nor shall any single or partial exercise of any power or right hereunder preclude other or further exercise thereof, or the exercise of any other power or right, and no waiver whatever shall be valid unless in writing, signed by the holder of this note, and only to the extent therein set forth. Should the Trust at any time make any call or calls for collateral or give any notice or notices of intention to sell collateral, or other notices, the making of such calls or the giving of such notices, no matter how many times repeated, shall not constitute a waiver of the right of the Trust to sell collateral, without demand or notice, in any of the contingencies herein enumerated in which the Trust is authorized to sell collateral without demand or notice.

Calls for collateral or any notices to any of the Makers by the Trust shall be addressed to the Makers at 5402 Fourth Avenue, Moline, Illinois.

Dated this 26th day of May, 1967 at Moline, Illinois.

Don E. Williams Company

(Corporate Seal)

By /s/ Don E. Williams
Its President,
Don E. Williams, Jr.
Accommodation Makers
/s/ Don E. Williams
Don E. Williams, Jr.
/s/ Alice R. Williams
Alice R. Williams
/s/ Joseph W. Phillips, Jr.
Joseph W. Phillips, Jr.

EXHIBIT 6

ASSIGNMENT

For Value Received, Don E. Williams, Jr. of East Moline, Illinois, hereby sells, assigns and transfers unto Don E. Williams Company Profit Sharing Trust, the profit sharing trust of the employees of the Don E. Williams Company with its principal place of business located in Moline, Illinois, four thousand one hundred eighty (4,180) shares of the ten dollars ($10.00) par value common stock of Don E. Williams Company, standing in the name of Don E. Williams, Jr. on the books of said corporation represented by certificates No. 11 and 15, attached hereto and by this reference made a part of this *Assignment,* and do hereby irrevocably constitute and appoint the Secretary of Don E. Williams Company, attorney to transfer the said stock on the books of the within named corporation with full power of substitution in the premises.

Dater this 26th day of May, 1967 at Moline, Illinois.

/s/ Don E. Williams, Jr.

State Of Illinois
Rock Island County—ss:

On this 26th day of May, 1967, before me, the undersigned, a Notary Public in and for said County, in said State, personally appeared Don E. Williams, Jr. to me known to be the identical person named in and who executed the within and foregoing instrument, and acknowledged that he executed the same as his voluntary act and deed.

/s/ Mary M. Zahnley
Notary Public in and for
Rock Island County, Illinois.

(Seal) My commission expires May 27, 1967.

EXHIBIT 7

ASSIGNMENT

For Value Received, Don E. Williams, Jr. of East Moline, Illinois, hereby sells, assigns and transfers unto Don E. Williams Company Profit Sharing Trust, the profit sharing trust of the employees of the Don E. Williams Company with its principal place of business located in Moline, Illinois, all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust arising by virtue of his status as an employee of the Don E. Williams Company, including the fair market value of his voluntary contributions as well as the fair market value of his share of the contributions made by the corporation.

Dated this 26th day of May, 1967 at Moline, Illinois.

/s/ Don E. Williams
Don E. Williams, Jr.

State Of Illinois
Rock Island County—ss:

On this 26th day of May, 1967, before me, the undersigned, a Notary Public in and for said County, in said State, personally appeared Don E. Williams, Jr., to me known to be the identical person named in and who executed the within and foregoing instrument, and acknowledged that he executed the same as his voluntary act and deed.

/s/ Mary M. Zahnley
Notary Public in and for
Rock Island County, Illinois.

(Seal) My commission expires May 27, 1967.

EXHIBIT 8

ASSIGNMENT

For Value Received, Joseph W. Phillips, Jr. of Rock Island, Illinois, hereby sells, assigns and transfers unto

Don E. Williams Company Profit Sharing Trust, the profit sharing trust of the employees of the Don E. Williams Company with its principal place of business located in Moline, Illinois, all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust arising by virtue of his status as an employee of the Don E. Williams Company, including the fair market value of his voluntary contributions as well as the fair market value of his share of the contributions made by the corporation.

Dated this 26th day of May, 1967 at Moline, Illinois.

/s/ Joseph W. Phillips, Jr.

State Of Illinois
Rock Island County—ss:

On this 26th day of May, 1967 before me, the undersigned, a Notary Public in and for said County, in said State, personally appeared Joseph W. Phillips, Jr., to me known to be the identical person named in and who executed the within and foregoing instrument, and acknowledged that he executed the same as his voluntary act and deed.

/s/ Mary M. Zahnley
Notary Public in and for
Rock Island County, Illinois.

(Seal) My commission expires May 27, 1967.

EXHIBIT 9

COLLATERAL PROMISSORY NOTE

For Value Received, the Don E. Williams Company, an Illinois corporation with its registered office located in Moline, Illinois, as Maker, Don E. Williams, Jr. of East Moline, Illinois, as an Accommodation Maker, Alice R. Williams, of Moline, Illinois, as an Accommodation Maker, Joseph W. Phillips, Jr., of Rock Island, Illinois, as an Accommodation Maker (hereinafter referred to collectively as "Makers"), each as principal, jointly and severally,

promise to pay to the order of the Don E. Williams Company Profit Sharing Trust, at Moline, Illinois, On Demand, the sum of Thirty-Four Thousand Three hundred Thirty-Three Dollars and Twenty-Six Cents ($34,333.26) with interest from May 1, 1968 at the rate of six percent (6%) per annum, payable at maturity.

The Makers hereof shall have the right and privilege at their option of making such prepayments of principal and interest at such time or times as they may in their discretion determine.

Any interest or principal not paid when due shall bear interest at the rate of seven percent (7%) per annum.

It is stipulated, that in any suit brought for the collection of this *Collateral Promissory Note,* a reasonable attorney's fee shall be allowed and taxed with the costs in such suit.

Don E. Williams, Jr., as and for collateral security for this promissory note, hereby deposits with the Don E. Williams Company Profit Sharing Trust the following; to-wit:

(a). certificates No. 11 and 15 for four thousand one hundred eighty (4,180) shares of the Ten Dollars ($10.00) par value common stock of Don E. Williams Company, together with an appropriate *Assignment;* and,

(b). an *Assignment* of all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust.

Joseph W. Phillips, Jr., as and for collateral security for this promissory note, hereby deposits with the Don E. Williams Profit Sharing Trust an *Assignment* of all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust.

The obligation evidenced by this note, and by any extensions or renewals thereof in whole or in part, are included in the expression "such liabilities" as hereinafter used.

The Makers agree to deliver to the Trust additional securities to its satisfaction, on demand, should the market value of any of the securities at any time held hereunder decline, or should any of such securities for other reasons be deemed unsatisfactory to the Trust.

On the nonperformance of any of the promises herein contained, or upon the nonpayment of any such liabilities at maturity, or in the case of the failure of the Makers to meet at maturity any liability of any of the Makers, either to the Trust or to any other party, or upon the failure of the Makers forthwith to furnish additional security to the satisfaction of the Trust as above provided, or upon the death, dissolution, termination of existence, declared insolvency or failure in business of, or appointment of a receiver for, or commission of any act of bankruptcy by, any of the Makers, or the entry of any judgment against any of the Makers, or a levy under a writ of attachment upon the credit or property of any of the Makers with the Trust, or in case any petition in bankruptcy shall be filed by or against any of the Makers, or any proceedings in bankruptcy or under any acts of Congress of other governmental authority relating to the relief of debtors should be commenced for the relief or readjustment of any indebtedness of any of the Makers, either through reorganization, composition, extension, or otherwise, all such liabilities of the Makers shall, at the option of the Trust, immediately mature and become forthwith due and payable, without demand or notice. In such event, full power and authority are hereby given the Trust to sell, assign, and deliver the whole or any part of such collateral at public or private sale, at such terms as it may deem best, without demand, advertisement, or notice of any kind, all of which are hereby expressly waived. If any such collateral is disposed of at private sale, the Trust shall be relieved from all liability of claim for inadequacy or price. At any such sale, the Trust may itself purchase the whole or any part of such collateral, free from any right of redemption on the part of any of the Makers, which is hereby waived and released.

In case of sale for any cause, or of receipt of any payments of principal or income on account of any of such collateral, the Trust may apply the proceeds of the sale or sales so made or the payments so received to pay any of such liabilities to the Trust, as the Trust or any one of its Trustees shall deem proper, returning the surplus, if any, to the appropriate Maker.

Notwithstanding the holding by the Trust of such collateral for the payment of such liabilities, or any sale, exchange, enforcement, collection of, realization upon, or compromise or settlement, actual or attempted, with reference to any of such collateral, the Makers shall be and remain liable for the payment in full of all such liabilities, except only to the extent that such liabilities, or any part thereof, shall be reduced by payment, or actual application thereon by the Trust of such collateral or the proceeds thereof.

The Trust shall not be liable for failure to collect, or demand payment of, or protest, or give notice of nonpayment of, such collateral, or any part thereof, or for any delay in so doing, nor shall the Trust be under obligation to take any action whatever in regard to such collateral or any part thereof.

The collateral may from time to time, by mutual consent, be exchanged for other property, which shall be held by the Trust subject to all the terms of this note. All the terms hereof shall apply to all notes given in extension or renewal of this note, and to all substituted and additional collateral.

The Trust may transfer this note, and may deliver and transfer the collateral or any part thereof then held, to any transferee, who shall thereupon become vested with all the rights of the Trust to the collateral so transferred, and the Trust shall thereafter be forever relieved and fully discharged from all liability or responsibility under this note as to such collateral or as indorser or otherwise; but

as respects any collateral not so transferred the Trust shall retain all rights hereby given.

No delay on the part of any holder hereof in exercising any power or right hereunder shall operate as a waiver of any power or right; nor shall any single or partial exercise of any power or right hereunder preclude other or further exercise thereof, or the exercise of any other power or right, and no waiver whatever shall be valid unless in writing, signed by the holder of this note, and only to the extent therein set forth. Should the Trust at any time make any call or calls for collateral or give any notice or notices of intention to sell collateral, or other notices, the making of such calls or the giving of such notices, no matter how many times repeated, shall not constitute a waiver of the right of the Trust to sell collateral, without demand or notice, in any of the contingencies herein enumerated in which the Trust is authorized to sell collateral without demand or notice.

Calls for collateral or any notices to any of the Makers by the Trust shall be addressed to the Makers at 5402 Fourth Avenue, Moline, Illinois.

Dated this 24th day of May, 1968 at Moline, Illinois.

Don E. Williams Company

(Corporate Seal)

By /s/ Don E. Williams
Its President,
Don E. Williams, Jr.
Accommodation Makers
/s/ Don E. Williams
Don E. Williams, Jr.
/s/ Alice R. Williams
Alice R. Williams
/s/ Joseph W. Phillips, Jr.
Joseph W. Phillips, Jr.

EXHIBIT 10

ASSIGNMENT

For Value Received, Don E. Williams, Jr. of East Moline, Illinois, hereby sells, assigns and transfers unto Don E. Williams Company Profit Sharing Trust, the profit sharing trust of the employees of the Don E. Williams Company with its principal place of business located in Moline, Illinois, four thousand one hundred eighty (4,180) shares of the ten dollars ($10.00) par value common stock of Don E. Williams Company, standing in the name of Don E. Williams, Jr. on the books of said corporation represented by certificates No. 11 and 15, attached hereto and by this reference made a part of this *Assignment,* and do hereby irrevocably constitute and appoint the Secretary of Don E. Williams Company, attorney to transfer the said stock on the books of the within named corporation with full power of substitution in the premises.

Dated this 24th day of May, 1968 at Moline, Illinois.

/s/ Don E. Williams, Jr.

State Of Illinois
Rock Island County—ss:

On this 24th day of May, 1968, before me, the undersigned, a Notary Public in and for said County, in said State, personally appeared Don E. Williams, Jr. to me known to be the identical person named in and who executed the within and foregoing instrument, and acknowledged that he executed the same as his voluntary act and deed.

/s/ Mary M. Zahnley
Notary Public in and for
Rock Island County, Illinois.

(Seal) My commission expires May 27, 1971.

EXHIBIT 11

ASSIGNMENT

For Value Received, Don E. Williams, Jr. of East Moline, Illinois, hereby sells, assigns and transfers unto Don E. Williams Company Profit Sharing Trust, the profit sharing trust of the employees of the Don E. Williams Company with its principal place of business located in Moline, Illinois, all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust arising by virtue of his status as an employee of the Don E. Williams Company, including the fair market value of his voluntary contributions as well as the fair market value of his share of the contributions made by the corporation.

Dated this 24th day of May, 1968 at Moline, Illinois.

/s/ Don E. Williams
Don E. Williams, Jr.

State Of Illinois
Rock Island County—ss:

On this 24th day of May, 1968, before me, the undersigned, a Notary Public in and for said County, in said State, personally appeared Don E. Williams, Jr. to me known to be the identical person named in and who executed the within and foregoing instrument, and acknowledged that he executed the same as his voluntary act and deed.

/s/ Mary M. Zahnley
Notary Public in and for
Rock Island County, Illinois.

(Seal) My commission expires May 27, 1971.

EXHIBIT 12

ASSIGNMENT

For Value Received, Joseph W. Phillips, Jr. of Rock Island, Illinois, hereby sells, assigns and transfers unto Don E. Williams Company Profit Sharing Trust, the profit

sharing trust of the employees of the Don E. Williams Company with its principal place of business located in Moline, Illinois, all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust arising by virtue of his status as an employee of the Don E. Williams Company, including the fair market value of his voluntary contributions as well as the fair market value of his share of the contributions made by the corporation.

Dated this 24th day of May, 1968 at Moline, Illinois.

/s/ Joseph W. Phillips, Jr.

State Of Illinois
Rock Island County—ss:

On this 24th day of May, 1968 before me, the undersigned, a Notary Public in and for said County, in said State, personally appeared Joseph W. Phillips, Jr., to me known to be the identical person named in and who executed the within and foregoing instrument, and acknowledged that he executed the same as his voluntary act and deed.

/s/ Mary M. Zahnley
Notary Public in and for
Rock Island County, Illinois.

(Seal) My commission expires May 27, 1971.

EXHIBIT 13

COLLATERAL PROMISSORY NOTE

For Value Received, the Don E. Williams Company, an Illinois corporation with its registered office located in Moline, Illinois, as Maker, Don E. Williams, Jr. of East Moline, Illinois, as an Accommodation Maker, Alice R. Williams, of Moline, Illinois, as an Accommodation Maker, Joseph W. Phillips, Jr., of Rock Island, Illinois as an Accommodation Maker (hereinafter referred to collectively as "Makers"), each as principal, jointly and severally, promise to pay to the order of the Don E. Williams Com-

pany Profit Sharing Trust, at Moline, Illinois, On Demand, the sum of Thirty-Five Thousand Three Hundred Thirty-Seven Dollars and Eighty-Six Cents ($35,337.86) with interest from May 1, 1969 at the rate of eight percent (8%) per annum, payable at maturity.

The Makers hereof shall have the right and privilege at their option of making such prepayments of principal and interest at such time or times as they may in their discretion determine.

Any interest or principal not paid when due shall bear interest at the rate of nine percent (9%) per annum.

It is stipulated, that in any suit brought for the collection of this *Collateral Promissory Note*, a reasonable attorney's fees shall be allowed and taxed with the costs in such suit.

Don E. Williams, Jr., as and for collateral security for this promissory note, hereby deposits with the Don E. Williams Company Profit Sharing Trust the following; to-wit:

(a). certificates No. 11 and 15 for four thousand one hundred eighty (4,180) shares of the Ten Dollars ($10.00) par value common stock of Don E. Williams Company, together with an appropriate *Assignment;* and,

(b). an *Assignment* of all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust.

Joseph W. Phillips, Jr., as and for collateral security for this promissory note, hereby deposits with the Don E. Williams Profit Sharing Trust an *Assignment* of all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust.

The obligation evidenced by this note, and by any extensions or renewals thereof in whole or in part, are included in the expression "such liabilities" as hereinafter used.

The Makers agree to deliver to the Trust additional securities to its satisfaction, on demand, should the market

value of any of the securities at any time held hereunder decline, or should any of such securities for other reasons be deemed unsatisfactory to the Trust.

On the nonperformance of any of the promises herein contained, or upon the nonpayment of any of such liabilities at maturity, or in the case of the failure of the Makers to meet at maturity any liability of any of the Makers, either to the Trust or to any other party, or upon the failure of the Makers forthwith to furnish additional security to the satisfaction of the Trust as above provided, or upon the death, dissolution, termination of existence, declared insolvency or failure in business of, or appointment of a receiver for, or commission of any act of bankruptcy by, any of the Makers, or the entry of any judgment against any of the Makers, or a levy under a writ of attachment upon the credit or property of any of the Makers with the Trust, or in case any petition in bankruptcy shall be filed by or against any of the Makers, or any proceedings in bankruptcy or under any acts of Congress of other governmental authority relating to the relief of debtors should be commenced for the relief or readjustments of any indebtedness of any of the Makers, either through reorganization, composition, extension, or otherwise, all such liabilities of the Makers shall, at the option of the Trust, immediately mature and become forthwith due and payable, without demand or notice. In such event, full power and authority are hereby given the Trust to sell, assign, and deliver the whole or any part of such collateral at public or private sale. at such terms as it may deem best, without demand, advertisement, or notice of any kind, all of which are hereby expressly waived. If any such collateral is disposed of at private sale, the Trust shall be relieved from all liability or claim for inadequacy of price. At any such sale, the Trust may itself purchase the whole or any part of such collateral, free from any right of redemption on the part of any of the Makers, which is hereby waived and released.

In case of sale for any cause, or of receipt of any payments of principal or income on account of any of such collateral, the Trust may apply the proceeds of the sale or sales so made or the payments so received to pay any of such liabilities to the Trust, as the Trust or any one of its Trustees shall deem proper, returning the surplus, if any, to the appropriate Maker.

Notwithstanding the holding by the Trust of such collateral for the payment of such liabilities, or any sale, exchange, enforcement, collection of, realization upon, or compromise or settlement, actual or attempted, with reference to any such collateral, the Makers shall be and remain liable for the payment in full of all such liabilities, except only to the extent that such liabilities, or any part thereof, shall be reduced by payment, or actual application thereon by the Trust of such collateral or the proceeds thereof.

The Trust shall not be liable for failure to collect, or demand payment of, or protest, or give notice of nonpayment of, such collateral, or any part thereof, or for any delay in so doing, nor shall the Trust be under obligation to take any action whatever in regard to such collateral or any part thereof.

The collateral may from time to time, by mutual consent, be exchanged for other property, which shall be held by the Trust subject to all the terms of this note. All the terms hereof shall apply to all notes given in extension or renewal of this note, and to all substituted and additional collateral.

The Trust may transfer this note, and may deliver and transfer the collateral or any part thereof then held, to any transferee, who shall thereupon become vested with all the rights of the Trust to the collateral so transferred, and the Trust shall thereafter be forever relieved and fully discharged from all liability or responsibility under this note as to such collateral or as indorser or otherwise; but as respects any collateral not so transferred the Trust shall retain all rights hereby given.

No delay on the part of any holder hereof in exercising any power or right hereunder shall operate as a waiver of any power or right; nor shall any single or partial exercise of any power or right hereunder preclude other or further exercise thereof, or the exercise of any other power or right, and no waiver whatever shall be valid unless in writing, signed by the holder of this note, and only to the extent therein set forth. Should the Trust at any time make any call or calls for collateral or give any notice or notices of intention to sell collateral, or other notices, the making of such calls or the giving of such notices, no matter how many times repeated, shall not constitute a waiver of the right of the Trust to sell collateral, without demand or notice, in any of the contingencies herein enumerated in which the Trust is authorized to sell collateral without demand or notice.

Calls for collateral or any notices to any of the Makers by the Trust shall be addressed to the Makers at 5402 Fourth Avenue, Moline, Illinois.

Dated this 30th day of May, 1969 at Moline, Illinois.

Don E. Williams Company
By /s/ Don E. Williams
Its President,
Don E. Williams, Jr.
Accommodation Makers
/s/ Don E. Williams.
Don E. Williams, Jr.
/s/ Alice R. Williams
Alice R. Williams
/s/ Joseph W. Phillips, Jr.
Joseph W. Phillips, Jr.

EXHIBIT 14

ASSIGNMENT

For Value Received, Don E. Williams, Jr. of East Moline, Illinois, hereby sells, assigns and transfers unto Don E. Williams Company Profit Sharing Trust, the profit sharing trust of the employees of the Don E. Williams Company with its principal place of business located in Moline, Illinois, four thousand one hundred eighty (4,180) shares of the ten dollars ($10.00) par value common stock of Don E. Williams Company, standing in the name of Don E. Williams, Jr. on the books of said corporation represented by certificates No. 11 and 15, attached hereto and by this reference made a part of this *Assignment,* and do hereby irrevocably constitute and appoint the Secretary of Don E. Williams Company, attorney to transfer the said stock on the books of the within named corporation with full power of substitution in the premises.

Dated this 30th day of May, 1969 at Moline, Illinois.

/s/ Don E. Williams, Jr.

State Of Illinois
Rock Island County—ss:

On this 30th day of May, 1969, before me, the undersigned, a Notary Public in and for said County, in said State, personally appeared Don E. Williams, Jr. to me known to be the identical person named in and who executed the within and foregoing instrument, and acknowledged that he executed the same as his voluntary act and deed.

/s/ Mary M. Zahnley
Notary Public in and for
Rock Island County, Illinois.

(Seal) My commission expires May 27, 1971.

EXHIBIT 15

ASSIGNMENT

For Value Received, Don E. Williams, Jr. of East Moline, Illinois, hereby sells, assigns and transfers unto Don E. Williams Company Profit Sharing Trust, the profit sharing trust of the employees of the Don E. Williams Company with its principal place of business located in Moline, Illinois, all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust arising by virtue of his status as an employee of the Don E. Williams Company, including the fair market value of his voluntary contributions as well as the fair market value of his share of the contributions made by the corporation.

Dated this 30th day of May, 1969 at Moline, Illinois.

/s/ Don E. Williams
Don E. Williams, Jr.

State Of Illinois
Rock Island County—ss:

On this 30th day of May, 1969, before me, the undersigned, a Notary Public in and for said County, in said State, personally appeared Don E. Williams, Jr. to me known to be the identical person named in and who executed the within and foregoing instrument, and acknowledged that he executed the same as his voluntary act and deed.

/s/ Mary M. Zahnley
Notary Public in and for
Rock Island County, Illinois.

(Seal) My commission expires May 27, 1971.

EXHIBIT 16

ASSIGNMENT

For Value Received, Joseph W. Phillips, Jr. of Rock Island, Illinois, hereby sells, assigns and transfers unto Don E. Williams Company Profit Sharing Trust, the profit sharing trust of the employees of the Don E. Williams Company with its principal place of business located in Moline, Illinois, all his right, title and interest in and to the Don E. Williams Company Profit Sharing Trust arising by virtue of his status as an employee of the Don E. Williams Company, including the fair market value of his voluntary contributions as well as the fair market value of his share of the contributions made by the corporation.

Dated this 30th day of May, 1969 at Moline, Illinois.

/s/ Joseph W. Phillips, Jr.

State Of Illinois
Rock Island County—ss:

On this 30th day of May, 1969, before me, the undersigned, a Notary Public in and for said County, in said State, personally appeared Joseph W. Phillips, Jr., to me known to be the identical person named in and who executed the within and foregoing instrument, and acknowledged that he executed the same as his voluntary act and deed.

/s/ Mary M. Zahnley
Notary Public in and for
Rock Island County, Illinois.

(Seal) My commission expires May 27, 1971.

UNITED STATES TAX COURT

No. 5946-71

Don E. Williams Company,

Petitioner,

vs.

Commissioner Of Internal Revenue,

Respondent.

ORDER AND DECISION

For cause appearing of record, it is

Ordered: That the decision entered on May 15, 1974, in the above-entitled case is hereby vacated and set aside, and it is further

Ordered and Decided: That there are deficiencies in income tax due from petitioner for the taxable years ended April 30, 1967, April 30, 1968 and April 30, 1969 in the amounts of $15,162.87, $1,360.64 and $530.42, respectively.

(Signed) William A. Goffe
Judge

SUPREME COURT OF THE UNITED STATES

No. 75-1312

Don E. Williams Company,

Petitioner,

vs.

Commissioner Of Internal Revenue,

Respondent.

Order Allowing Certiorari. Filed June 7, 1976.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit is granted.

No. 75-1312

In the Supreme Court of the United States

OCTOBER TERM, 1975

DON E. WILLIAMS CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

ROBERT H. BORK,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1312

DON E. WILLIAMS CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

The question presented in this federal income tax case is whether petitioner's accrual of a liability to the trustees of its employees' profit-sharing plan prior to the close of its taxable year and its delivery of its promissory note to the trustees during the first months of the following taxable year was a "payment" to the plan within the meaning of Section 404(a) of the Internal Revenue Code of 1954, so as to entitle petitioner to an income tax deduction in the face amount of the note for the year in which the liability was accrued. Both the Tax Court (62 T.C. 166) and the court of appeals (527 F.2d 649) held that petitioner's delivery of its note was not a "payment" under the statute.

The pertinent facts are as follows: Petitioner is a corporation that maintains its books and records and files its income tax returns on the accrual method of accounting. Since 1964, petitioner has had a profit-sharing plan for its employees, which was qualified under Section 401(a) of the Code. The trustees of the plan were the principal shareholders and officers of petitioner, Don E.

Williams, Jr., Joseph W. Phillips, Jr., Alice R. Williams, and the First National Bank of Moline (Pet. App. A 2a; Stip., pars. 8, 9).[1]

In the final days of its taxable years ending April 30, 1967, 1968, and 1969, petitioner's board of directors authorized contributions to its profit-sharing plan of $31,589.32, $34,333.26, and $35,337.86, respectively. Petitioner accrued these amounts as liabilities on its books at the close of each taxable year (Pet. App. A 3a; Stip., pars. 11-27).

During the month immediately following the accrual of these liabilities to the profit-sharing plan, petitioner delivered to the trustees of the plan its interest-bearing promissory notes payable on demand in the face amounts of the accrued liabilities. The notes issued in 1967 and 1968 bore interest at 6 percent and the 1969 note bore interest at 8 percent. The notes were guaranteed by the officers and principal shareholders of petitioner and secured by collateral consisting of stock of petitioner and the interests of two of the shareholders in the profit-sharing plan. It was stipulated that the value of the collateral plus the net worth of one of the guarantors exceeded the face amount of each note (Pet. App. A 3a; Pet. App. B 14a).

On April 4, 1968, petitioner delivered its check for $33,353.03 to the trustees of its profit-sharing plan in payment of its May 26, 1967, promissory note of $31,589.32 plus accrued interest of $1,763.71. On April 28, 1969, petitioner delivered its check for $36,381.81 to the trustees in payment of its May 24, 1968 note of $34,333.26 plus accrued interest of $2,048.55. Finally, on March 31, 1970, petitioner delivered its check for $37,929.21 to the trustees in payment of its May 30, 1969 note of $35,337.86 plus $2,591.45 of accrued interest (Pet. App. A 3a; Stip., pars. 11-27).

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[1]"Stip." refers to the stipulation set forth at pages 6-13 of petitioner's brief filed in the court of appeals.

On audit, the Commissioner of Internal Revenue determined that petitioner's delivery of its demand promissory notes to the trustee of its profit-sharing plan did not constitute "payment" to the plan within the meaning of Section 404(a) of the Code. He accordingly disallowed petitioner's claimed deductions for the year in which it accrued the liabilities in the face amounts of the notes and allowed deductions for those years only to the extent of petitioner's actual payments to the plan (Pet. App. A 2a). In a reviewed decision with three dissents, the Tax Court upheld the Commissioner's position that the requirement of "payment" of Section 404(a) of the Code is not satisfied by the delivery of promissory notes (Pet. App. A 1a-12a). The court of appeals unanimously affirmed (Pet. App. B 13a-20a).

1. Section 404(a) of the Code provides that "[i]f contributions are paid by an employer to * * * a * * * profit-sharing * * * plan," the contributions shall be deductible "[i]n the taxable year when paid * * * ." Section 404(a)(6) establishes a special rule for accrual basis taxpayers who make such contributions. It states that "a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof)."

Here, petitioner, an accrual basis taxpayer, delivered its promissory notes to its profit-sharing plan after the close of its taxable year but prior to the time it was required to file its return for that year.[2] If petitioner

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[2]Pursuant to Section 6072(b) of the Code, a corporation is required to file its income tax return on or before two and one-half months after the close of its taxable year. Since petitioner's

had paid its accrued liabilities to the plan at the times it delivered its promissory notes to the trustees, it would have come within the special rule of Section 404(a)(6) that enables accrual basis taxpayers to deduct such contributions for the preceding taxable year as long as they are paid prior to the filing of its return for that year. But petitioner did not "pay" the amount of the accrued liabilities; it delivered its note which it did not pay until after it filed its returns for the years in which it accrued the corresponding liabilities and claimed deductions. Under these circumstances, the courts below correctly held that the delivery of notes was not a "payment" within the meaning of Section 404(a) of the Code.

2. The pertinent legislative history confirms that the payment requirement of Section 404(a) is not met by the delivery of a promissory note. In describing the predecessor[3] of the accrual basis rule now set forth in Section 404(a)(6), the House Committee Report observed: "An employer on the accrual basis of accounting may under existing law deduct contributions *actually paid* within the first 60 days of the subsequent year" H.R. Rep. No. 2087, 80th Cong., 2d Sess., p. 13 (1948) (emphasis supplied). Moreover, in extending the 60-day period to two months and 15 days at the time of the 1954 codification, Congress reaffirmed the "actual payment" requirement. See S. Rep. No. 1622, 83d Cong., 2d Sess., p. 55 (1954). In light of these clear statements of legislative intent, the court of appeals correctly interpreted the congressional reference to "actually paid" to "connote a liquid form of payment and not a promissory note which is in substance only another form of an obligation to pay" (Pet. App. B 17a).

taxable year ended April 30, it could have made a "payment" under Section 404(a)(6) on or before July 15 that would have been deductible for the preceding taxable year.

[3]The statutory predecessor of Section 404(a)(6) of the current Code is Section 23(p)(1)(E) of the 1939 Code. The 60-day grace period was extended to two months and 15 days by Section 404(a)(6) of the 1954 Code. See H.R. Rep. No. 1337, 83d Cong., 2d Sess., p. A151 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 55, 292 (1954). The House had first recommended this extension in 1948. See H.R. Rep. No. 2087, 80th Cong., 2d Sess., p. 13 (1948).

Treasury Regulations (26 C.F.R.), Section 1.404(a)-1(c), similarly provides that an accrual basis taxpayer may deduct an accrued contribution to a profit-sharing plan for the year of accrual "provided payment is actually made not later than the time prescribed by law for filing the return for the taxable year of accrual * * *."

Thus, apart from the two and one-half month grace period applicable to accrual basis taxpayers such as petitioner, Section 404(a) puts cash and accrual basis taxpayers on the same footing. Both must make actual payment to a profit-sharing plan to be eligible for the deduction.

Petitioner does not deny that Section 404(a) requires more than an accrual of the liability to the profit-sharing plan.[4] The only question therefore is what constitutes "actual payment" under the statute. Since the statute requires both cash basis and accrual basis taxpayers to make actual payment as a prerequisite for the deduction, petitioner is subject to the same rule applicable to a cash basis taxpayer. As the court of appeals correctly recognized (Pet. App. B 15a-16a), the decisions of this Court have

[4]When Congress intended to permit accrual basis taxpayers to deduct accrued but unpaid items, it has employed the term "paid or incurred" or "paid or accrued." See Sections 162(a) (business expenses), 163(a) (interest), and 164(a) (taxes).

long held that the giving of a promissory note by a cash basis taxpayer does not constitute "actual payment" for federal tax purposes.

In *Eckert* v. *Burnet,* 283 U.S. 140, the Court held that the endorser of the note of an insolvent maker could not claim a bad debt deduction upon taking up the note and substituting one of his own notes to the creditor. There, the Court stated, in quoting from the opinion of the Board of Tax Appeals with approval, that the taxpayer "merely exchanged his note under which he was primarily liable for the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value" (283 U.S. at 141; 17 B.T.A. at 266).

Similarly, in *Helvering* v. *Price,* 309 U.S. 409, the Court on the authority of *Eckert* rejected the argument, advanced by petitioner in the courts below, that the delivery of a secured note in satisfaction of an obligation gave rise to a tax deduction. In the Court's view, "if [the] promise to pay was not sufficient to warrant the deduction until the promise was made good by actual payment, the giving of security for performance did not transform the promise into the payment required to constitute a deductible loss in the taxable year" (309 U.S. at 414). Here, too, petitioner's giving of a note does not entitle it to a deduction because "[i]f the note is never paid, [it] has parted with nothing more than [its] promise to pay." *Hart* v. *Commissioner,* 54 F.2d 848, 852 (C.C.A. 1).[5]

[5]The lower courts have applied the principle established in *Eckert* and *Price* in denying a variety of claimed deductions. See, *e.g., Cleaver* v. *Commissioner,* 158 F.2d 342 (C.C.A. 7) (giving of note is not interest "paid" for purpose of the interest deduction); *Jenkins* v. *Bitgood,* 101 F.2d 17 (C.C.A. 2) (giving of note is not actual payment for purposes of the loss deduction); *Baltimore Dairy Lunch* v. *United States,* 231 F.2d 870, 875 (C.A. 8) (same).

3. Although the Tax Court has consistently upheld the Commissioner's position that the delivery of a note is not "payment" within the meaning of Section 404(a),[6] three courts of appeals have treated the contribution of promissory notes to profit-sharing plans as "payment" under Section 404(a) or its substantially identical predecessor, Section 23(p) of the 1939 Code. See *Sachs* v. *Commissioner,* 208 F.2d 313 (C.A. 3) (demand promissory note payable at a bank); *Time Oil Co.* v. *Commissioner,* 258 F.2d 237 (C.A. 9) (non-interest bearing demand promissory note); and *Wasatch Chemical Co.* v. *Commissioner,* 313 F.2d 843 (C.A. 10) (five-year unsecured promissory note). In the view of those courts of appeals, the delivery of a demand note is equivalent to the giving of a check. However, unlike a check which is an order to a bank to pay money as directed, a note is only a promise to pay, the delivery of which is not actual payment. These decisions are, as petitioner asserts (Pet. 8-11) and the court of appeals acknowledged (Pet. App. B 17a-19a), in conflict with the decision in this case. Moreover, the Internal Revenue Service advises that there are 116 cases pending administratively involving the issue with $3,675,000 of taxes at stake.[7]

[6]See *Logan Engineering Co.* v. *Commissioner,* 12 T.C. 860; *Freer Motor Transfer* v. *Commissioner,* 8 T.C.M. 507; *Slaymaker Lock Co.* v. *Commissioner,* 18 T.C. 1001, reversed *sub nom. Sachs* v. *Commissioner,* 208 F.2d 313 (C.A. 3); *Time Oil Co.* v. *Commissioner,* 26 T.C. 1061, reversed, 258 F.2d 237 (C.A. 9); *Wasatch Chemical Co.* v. *Commissioner,* 37 T.C. 817, reversed, 313 F.2d 843 (C.A. 10).

[7]The issue is also pending in the following cases: *Coastal Electric Corp.* v. *Commissioner,* 34 T.C.M. 1007, appeal pending, C.A. 4, No. 75-2184; *Lancer Clothing Corp.* v. *Commissioner,* 34 T.C.M. 776, appeal pending, C.A. 2, No. 76-4012; *Patmon, Young & Kirk Professional Corp.* v. *Commissioner,* 34 T.C.M. 798, appeal pending, C.A. 6, No. 75-2214.

Accordingly, we do not oppose the granting of the petition for a writ of certiorari.

Respectfully submitted.

ROBERT H. BORK,
Solicitor General.

MAY 1976.

In The

Supreme Court of the United States

October Term, 1975

No. 75-1312

DON E. WILLIAMS COMPANY,
Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF FOR DON E. WILLIAMS COMPANY

MARVIN L. SCHRAGER
DURWARD J. LONG, SR.
912 - 16th Avenue
East Moline, Illinois 61244
Attorneys for Appellant

PETITION FOR CERTIORARI FILED MARCH 13, 1976
CERTIORARI GRANTED JUNE 7, 1976

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Appellant,

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Appellee.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

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BRIEF FOR DON E. WILLIAMS COMPANY

OPINIONS BELOW

The opinion of the Court of Appeals (Petitioner's Petition for Writ of Certiorari, Appendix B) is reported at 527 F.2d 649. The opinion of the Tax Court (Petitioner's Petition for Writ of Certiorari, Appendix A) is reported at 62 T.C. 166.

JURISDICTION

The judgment of the Court of Appeals (Joint App.) was entered on December 16, 1975. A petition for a writ of certiorari was filed on March 13, 1976, and was granted on June 7, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

I. Whether the delivery by Don E. Williams Company, an accrual basis taxpayer, of a promissory note with a face value of $31,589.32 secured by an assignment by the President and Vice President of their interests in the Profit Sharing Trusts, an assignment by the President of his 4,180 shares of $10.00 par value common stock of the Don E. Williams Company and personally guaranted by the President, Vice President and Secretary-Treasurer of the Don E. Williams Company constituted the "payment" under 26 U.S.C. § 404 to the Profit Sharing Trust of Don E. Williams Company's $31,589.32 designated contribution to the Profit Sharing Trust for the year ended April 30, 1967.

II. Whether the delivery by Don E. Williams Company, an accrual basis taxpayer, of a promissory note with a face value of $34,333.26 secured by an assignment by the President and Vice President of their interests in the Profit Sharing Trusts, an assignment by the President of his 4,180 shares of $10.00 par value common stock of the Don E. Williams Company and personally guaranteed by the President, Vice President and Secretary-Treasurer of Don E. Williams Company constituted the "payment"

under 26 U.S.C. § 404 to the Profit Sharing Trust of Don E. Williams Company's $34,333.26 designated contribution to the Profit Sharing Trust for the year ended April 30, 1968.

III. Whether the delivery by Don E. Williams Company, an accrual basis taxpayer, of a promissory note with a face value of $35,337.86 secured by an assignment by the President and Vice President of their interests in the Profit Sharing Trusts, an assignment by the President of his 4,180 shares of $10.00 par value common stock of the Don E. Williams Company and personally guaranteed by the President, Vice President and Secretary-Treasurer of Don E. Williams Company constituted the payment under 26 U.S.C. § 404 to the Profit Sharing Trust of Don E. Williams Company's $35,337.86 designated contribution to the Profit Sharing Trust for the year ended April 30, 1969.

STATUTES INVOLVED

The Internal Revenue Code Of (1954), §§ 404(a)(3)(A) & (6), 26 U.S.C. § 404(a)

(3) Stock bonus and profit-sharing trusts:

(A) Limits on deductible contributions. In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the stock bonus or profit-sharing plan. . . .

(6) Taxpayers on accrual basis:

For purposes of paragraphs (1), (2), and (3), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

STATEMENT

This appeal arises out of a complaint brought by the Petitioner, Don E. Williams Company, (hereinafter "Dewco") against the Respondent, Commissioner of Internal Revenue (hereinafter "C.I.R."). In its complaint Petitioner asked for a redetermination of the deficiency set forth by the C.I.R. in his Notice of Deficiency dated May 25, 1971.

The deficiency, which Petitioner feels is in error, as determined by the C.I.R. is in income tax as follows and results from disallowance of tax deductions.

Fiscal Year Ending	*Amount of Disallowance*	*Amount/Tax Assessed*
April 30, 1967	\$31,589.32	\$15,162.87
April 30, 1968	\$ 2,743.94	\$ 1,360.64
April 30, 1969	\$ 1,004.60	\$ 530.42

The commissioner erroneously determined for fiscal year ending April 30, 1967, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of \$31,589.32, and within the "grace period" allowed an accrual basis taxpayer by § 404 (a)(6) of the Internal Revenue Code of 1954 to the

Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404 (a) of the Internal Revenue Code of 1954.

The commissioner erroneously determined for fiscal year ending April 30, 1968, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of \$34,333.26, within the "grace period" allowed an accrual basis taxpayer by § 404 (a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404 (a) of the Internal Revenue Code of 1954.

The commissioner erroneously determined for fiscal year ending April 30, 1969, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of \$35,337.86, within the "grace period" allowed an accrual basis taxpayer by § 404 (a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404 (a) of the Internal Revenue Code of 1954.

The facts and exhibits were stipulated to by the parties and the case was submitted to the Tax Court of the United States.

Judgment was entered for the Respondent, with three judges dissenting, assessing deficiencies in income tax due from Petitioner as set forth above.

On appeal, the United States Court of Appeals for the Seventh Circuit affirmed, however, in doing so they declined to follow decisions of the Third, Ninth, and Tenth Circuits and also a district court decision in the Seventh Circuit.

ARGUMENT

I.

FOR AN ACCRUAL BASIS TAXPAYER THE GIVING OF A DEMAND PROMISSORY NOTE CONSTITUTES "PAYMENT" WITHIN THE MEANING OF SECTION 404(a)(6).

The Commissioner of Internal Revenue denied the Petitioner a deduction under Section 404(a), Int. Rev. Code of 1954 (26 U.S.C.) claiming that the taxpayer's contribution to its profit sharing plan was not "paid", as defined by Section 404(a), by the giving of a secured interest bearing demand promissory note and that consequently, "payment" was not made as defined in Section 404(a)(6).

Petitioner was on the accrual basis method of accounting. Notwithstanding that fact, the Commissioner contends that the sole use of the word "paid" in Section 404(a) as distinguished from the use of the terms "paid or incurred" and "paid or accrued" in other deduction sections of the Code automatically converts an accrual basis taxpayer to the cash basis method of accounting for the purposes of Section 404(a). This is a position which had been unanimously rejected by courts of appeals for the Third, Ninth and Tenth Circuits. *Sachs* v. *Commissioner,* 208 F.2d 313 (C.A. 3, 1953); *Time Oil Co.* v. *Commissioner,* 258 F.2d 237 (C.A. 9, 1958); *Wasatch Chemical Co.* v. *Commissioner,* 313 F.2d 843 (C.A. 10, 1963). These decisions are consistent with the principles of accrual accounting.

Section 404(a) is not the only section of the Code where the word "paid" is used in such a manner. Section 267(a)(2)(A), Int. Rev. Code of 1954 (26 U.S.C.), which also dealt

with deductions for employee compensation, in pertinent part reads:

> ... Losses, expenses, and interest with respect to transactions between related taxpayers....
> (2) *Unpaid expenses and interest.* ... In respect of expenses, otherwise deductible under section 162 or 212, or of interest, otherwise deductible under section 163,—
>
> (A) If within the period consisting of the taxable year of the taxpayer and 2½ months after the close thereof (i) such expenses or interest are *not paid.* ... (Emphasis added)

The forerunner of Section 267(a)(2)(A) was Section 24(c)(1), Int. Rev. Code of 1939, which was substantially the same and also contained the word "paid".

In the case of *Anthony P. Miller, Inc.* v. *Commissioner,* 164 F.2d 268 (C.A. 3, 1947) the taxpayer accrued salary to its president and, the day after the close of the taxable year, delivered negotiable demand notes in discharge of the liability. These notes were, in fact, redeemed two years later. The Commissioner of Internal Revenue had denied the corporation a deduction for the salary on the ground that it was not paid within two and one-half months after the close of the taxable year, as was required under Section 24(c)(1). The court held that by the giving of the notes, the taxpayer paid its president's salary within the meaning of Section 24(c)(1). In addition to *Miller, Supra,* there is ample authority to the effect that delivery of a promissory note by an accrual basis taxpayer constituted "payment" under Section 24(c)(1). *Musselman Hub-Brake Co.* v. *Commissioner,* 139 F.2d 65 (C.A. 6, 1943); *Celina Manufacturing Company* v. *Commissioner,* 142 F.2d 449 (C.A. 6, 1944); *Mundet Cork Corporation* v. *Commissioner,*

173 F.2d 757 (C.A. 2, 1949); and *Akron Welding and Spring Co.*, 1948, 10 T.C. 715.

The court of appeals below in its opinion does not dispute the correctness of the *Miller* line of cases and makes no effort to distinguish them from this case. A holding adverse to the taxpayer here could cast serious doubts as to the validity of the *Miller, Supra,* case and all the other cases which hold that the "paid" requirements of Section 24(c)(1) are fulfilled by an accrual basis taxpayer's giving of a promissory note. The Tax Court below attempts to distinguish the *Miller* decision on the ground that it deals with a different statute and that Section 404(a) precludes deductions for contributions under Sections 162 and 212 of the Int. Rev. Code of 1954. (Pet. for Cert., App. A p. 6a) However, the courts have held that when the same word is used in two places in the Code, it is ordinarily to be given the same meaning in both places. *Meyer* v. *United States,* 175 F.2d 45, 47 (C.A. 2, 1949); *Lewellyn* v. *Harbison,* 31 F.2d 740 (C.A. 3, 1929); *Commissioner* v. *Estate of Ellis Branson Ridgeway,* 291 F.2d 257, 259 (C.A. 3, 1961). The Tax Court's reasoning also ignores the fact that the nature of the deductions is basically the same, namely, employee compensation.

It should be noted that in the instant case the trustees of the profit-sharing plan were required to report the notes they received as income on their annual information reports to the Internal Revenue Service. Section 6047, Int. Rev. Code of 1954 (26 U.S.C.). Except for the exempt status granted the trust by Section 501(c), Int. Rev. Code of 1954, the receipt of the taxpayer's notes would have constituted taxable income. Accordingly, as a promissory note paid a president's salary in the *Miller, Supra,* case, the

taxpayer's promissory note in the instant case paid its contribution to the employees' profit-sharing plan.

In deciding against the Petitioner, the court of appeals below chose not to follow the prior decisions of the Third, Ninth and Tenth Circuits[1] which held that the giving of a promissory note by an accrual basis taxpayer constituted "payment" under Section 404(a)(6) and its predecessor, Section 23(p)(1)(E). (Pet. for Cert., App. B p. 19a) The Third Circuit decisions were *Slaymaker Lock Co.* v. *Commissioner* and *Sachs* v. *Commissioner,* 208 F.2d 313 (C.A. 3, 1953), where the taxpayers transferred their own demand note to the trustee of the pension fund. Because of the similarities between Section 23(p)(1)(E), the forerunner of Section 404(a)(6), and Section 24(c)(1) of the Code, the *Sachs* court analyzed and correctly relied upon the *Miller* case. 208 F.2d at 315. Finding no compelling reason to construe the word "paid" differently as used in Section 23(p)(1)(E), the court held for the taxpayer and granted a deduction. In relying on *Miller, Supra,* the *Sachs* court was on solid ground. There is no rational reason, nor anything in the legislative history of Section 23(p) (now Section 404(a)) which justifies a different interpretation of the word "paid" as determined in *Miller.* (See Petitioner's Argument Infra)

Next, the Ninth Circuit in *Time Oil Co.* v. *Commissioner, Supra,* approved the Third Circuit's decision in *Sachs* and its reliance on the *Miller* case. In *Time Oil,* the taxpayer corporation delivered non-interest bearing demand notes to the trustee and later replaced the notes with stock. The

[1] *Sachs* v. *Commissioner,* 208 F.2d 313 (C.A. 3, 1953); *Time Oil Co.* v. *Commissioner,* 258 F.2d 237 (C.A. 9, 1958); *Wasatch Chemical Co.* v. *Commissioner,* 313 F.2d 843 (C.A. 10, 1963).

court was asked to rule as to whether the delivery constituted payment. The court held that delivery of the notes constituted "payment" as of the delivery date and that the delivery date would determine the year of deductibility.

Then in *Wasatch Chemical Company* v. *Commissioner, Supra,* the Tenth Circuit held that the giving of a note constituted payment under Section 404(a)(6). By its holding, the Tenth Circuit adopted the rationale of both *Sachs* and *Time Oil* and their reliance on the *Miller* case. Additionally, the court in *Wasatch* relied on the Tax Court opinion in *Colorado National Bank of Denver* v. *Commissioner,* 30 T.C. 933 (1958) when it stated:

> Further as to whether cash is required the Tax Court in *Colorado National Bank of Denver* v. *Commissioner* . . . held that a contribution to a pension trust under Section 404 may be paid by a conveyance of real estate to the trustees. The Tax Court mentioned in the opinion:
>
> > "A payment need not be cash and even a debt can be paid in property if the debtor is willing to accept the property as payment. There is no reason why a contribution to a pension trust could not be made in property and still be deductible."
>
> The opinion, however, says the transfer there made did not resemble a promissory note and that it was a present transfer of an asset having a worth of a stated amount. The opinion certainly stands for the proposition that a transfer of something of value is recognized as payment.

Furthermore, a district court in the taxpayer's own circuit has held that the transfer of a note constitutes "payment" within the meaning of Section 404(a). *Advance Construction Co., Inc.* v. *United States of America,* 356 F. Supp. 1267 (N.D. Ill., 1973). In broad language the court said that the giving of a note was the precise point when an

intangible obligation to contribute to the plan was transformed into a tangible delivery of something of current cash value. 365 F. Supp. at 1272. The court as in *Wasatch, Supra,* indicated that the real issue was to ascertain the value of the note. 356 F. Supp. at 1274.

Until the opinion of the court of appeals below, the issue was well settled that accrual basis taxpayers' use of promissory notes constituted "payment" under Section 404 (a)(6). Although the Government and the Tax Court continued to disagree, whenever the issue was presented on appeal, their position was rejected. Thus, for more than twenty years highest precedent, upon which Petitioner and other taxpayers relied, approved the use of notes for accrual basis taxpayers under said Section 404(a)(6). (*See* Judge Quealy's dissenting opinion, Pet. for Cert., App. A p. 12a)

"Payment" by note under Section 404(a)(6) is now prohibited by the enactment of the Employees' Retirement Income Security Act of 1974 (hereinafter called "ERISA"). The Government so conceded in the court of appeals below. Thus, the precedent which the Government would have this Court overturn has no prospective meaning after the effective date of ERISA. Consequently, Petitioner respectfully submits that no reason exists why more than twenty years of precedent should now be overturned.

II.

FOR THE PURPOSES OF AN ACCRUAL BASIS TAXPAYER THE ISSUE IS WHETHER THE VALUE OF THE NOTE TRANSFERRED TO THE TRUSTEES EQUALED OR EXCEEDED THE AMOUNT OF THE CLAIMED DEDUCTION.

Section 404(a) provides for deductions "if contributions are paid". The word "contribution" has been defined to "at

least require some right to be relinquished or some obligation incurred by the contributor". *Norman Petty*, 40 T.C. 521, 523 (1963). Under Section 404(a)(6) a "payment" need not be in cash and can be paid in property if the creditor is willing to accept the property as payment. *Colorado National Bank of Denver* v. *Commissioner, Supra.* A contribution in kind is paid by the transferring of promissory notes of third parties owed to the taxpayer. Petitioner submits that the result should be the same when a taxpayer contributes its own promissory note. The important issue is whether something of value was transferred by the contributor.

Immediately after the transfer of the note the trustee of the profit-sharing plan could have negotiated the note to a third party and received cash or other property. A mere promise to pay a contribution to a profit-sharing fund at a future date creates no decrease in the company's assets, no increase in the funds' assets, and fails to provide the recipient with the physical evidence of current cash value. *Advance Construction Co.* v. *United States, Supra.* However, the tangibility and physical evidence of a promissory note constitutes the transfer of something of current cash value and represents payment under Section 404(a)(6). *Advance Construction Co.* v. *United States, Supra.* When a debtor gives a creditor a negotiable instrument for a debt, legal relations between the parties change. *Anthony P. Miller, Inc.* v. *Commissioner, Supra.* The obligations of the taxpayer under his promissory note and the rights of the payee or any subsequent holder of the promissory note are fixed.[2]

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[2] See Sections 3-301 *et seq.*, and Sections 3-401 *et seq.*, Commerercial Code, Smith-Hurd Ill. Annot. Stat., Ch. 26.

In addition, the promissory note represents a form of investment in the company, when the note is fully secured and bears interest as in this case. The taxpayer can avoid the circuitous route of giving cash and then having the funds lent back through the use of a note. *Advance Construction Co.* v. *United States, Supra.* Also, if the Court of Appeals' argument is followed to its logical conclusion, the taxpayer could satisfy the payment requirement by giving a check which is not cashed but instead returned in exchange for a promissory note. It would be unrealistic and pointless to require the writing of a check to the trust, the negotiation of that check back to the taxpayer and the simultaneous issuance of a note representing the loan. So long as the loaning of the funds by the trust is proper, which is undisputed in this instance. It is clear that the Government's attack only goes to the form of the transaction and not to its substance. This Court has recognized the principle that in matters of taxation, substance should prevail over form. *United States* v. *Phellis*, 257 U.S. 156, 168.

Thus, the real question to decide is not whether the taxpayer's note constitutes property but what is the value of the note. In this case the parties have stipulated that the notes equaled the amount of the claimed deduction. (Pet. App. ......) Petitioner submits that the giving of a promissory note and its comparable cash value as property constitutes payment within Section 404(a)(6) for an accrual basis taxpayer.

Taxpayers in similar circumstances to Petitioner could, as the Government would require, make a cash distribution to the plan and then have the cash returned to them by the trustees of the plan in exchange for a promissory note.

Such a circuitous transaction would not only incur additional administrative expenses, but also add to the complexity of operating a pension and profit-sharing plan, thereby discouraging more and more small employers from using such plans. In addition, the end result would be no different from the result reached in Petitioner's case and the cases it relies upon.

Also, the court of appeal's concern for evaluation problems (Pet. for Cert. App. B, 20a) is inconsistent in light of *Colorado National Bank of Denver* v. *Commissioner, Supra,* where a transfer of property was allowed. If the Commissioner is able to determine the value of property, he can surely do so for notes. Further, as ERISA makes this no longer a problem for the Commissioner, certainly whatever evaluation difficulties that may arise are minimal.

III.

THE COURT OF APPEALS ERRED IN TREATING CASH AND ACCRUAL BASIS TAXPAYERS ALIKE.

The court of appeals suggests that legislative history supports the conclusion that the "payment" requirement of Section 404(a) is not fulfilled by the Petitioner's delivery of a demand promissory note. (Pet. for Cert. App. B, P. 17a) Petitioner disagrees with that analysis.

Subparagraph (E) of Section 23(p)(1) of the Internal Revenue Code, predecessor of Section 404(a)(6), was added to H.R. 7378, 77th Congress, 2nd Session (1942 Act), by the Senate Finance Committee following hearings in which Mr. Richard D. Sturtevant, Assistant Secretary of Jewel Tea Co., pointed out that certain provisions in the House bill would destroy profit sharing plans of accrual basis

taxpayers like themselves. He testified before the Senate Finance Committee that the Jewel Tea Co. plan was a profit-sharing plan for employees whereby the company contributed a definite percentage of the profits each year over and above certain earnings on the common stock and that the company could not possibly determine until after the close of the year what would be the amount of the contribution. (See Hearings on H.R. 7378, 77th Cong. 2d Sess., Senate Finance Committee, pp. 461, 462, 465).

Thus, Petitioner contends that subparagraph 23(p)(1) (E) (the forerunner of Section 404(a)(6)) was adopted by Congress primarily to afford profit-sharing trusts 60 days after the close of the year to compute and make payment of an accrued liability for a contribution to any such trust because of the difficulty in determining the amount before the close of the year. There is nothing in the legislative history to indicate how payment should be made or that payment for an accrual basis taxpayer is the same as a cash basis taxpayer.

The court of appeals' opinion rests on the proposition that for the purposes of Section 404(a)(6) accrual and cash basis taxpayers are on an equal footing with respect to contributions to employees' trusts. (Pet. for Cert. App. B, p. 15a) Such a conclusion is unsupported. The Government's case should fall unless it demonstrates that the purpose of Section 404(a)(6) was to convert an accrual basis taxpayer's method of accounting to cash basis for the purpose of contribution to an employer's profit-sharing plan.

Section 404(a)(6) allows the taxpayers on the accrual basis an additional period of 75 days beyond the close of the taxable year within which payments to employees' trusts

may be made and deduction taken as though the payment had actually been made within the taxable year. But this additional grace period was not given to those on the accrual basis only. Thus, in spite of the provisions of Section 404 (a)(6), a cash basis taxpayer still had to make his type of payment within the taxable year, while another taxpayer, with perhaps an identical employee trust, had an additional 75 days to make his payment because such taxpayer happened to be on the accrual basis. Accordingly, what constitutes payment for an accrual basis taxpayer under Section 404(a)(6) should not be influenced by the requirements of a cash basis taxpayer.

This argument is supported by the Employees' Retirement Income Security Act of 1974 (ERISA). Under ERISA, tax deductible contributions to all qualified plans may be made at any time up to the filing date for Federal income tax returns, corporate, partnership or individual as the case might be, including any extension, Section 1013(c)(2); Section 404(a)(6) as amended, Int. Rev. Code of 1954. Now cash basis taxpayers are given the same advantages of the extension of time to make payments as an accrual basis taxpayer. Thus, Section 404(a)(6) does not convert accrual basis taxpayers to a cash method of accounting with respect to contributions to profit-sharing plans. Cf. *Musselman Hub-Brake Co.* v. *United States, Supra*, where the same argument was advanced by the Government and rejected by the court.

The court of appeals below felt that the term "actually paid", as used by the Ways and Means Committee Report on the Revenue Revision Act of 1948, prevents a promissory note from constituting "payment". (Pet. for Cert. App. B, p. 17a) It is unclear how the word "actually" clarifies the

matter as the Government contends. If a promissory note constitutes "payment" within the meaning of Section 404 (a)(6), then it surely constitutes "actual payment"[3] and thus, the contribution is "actually paid". If Congress intended "a liquid form of payment", then it would have used the term "paid in money" as it did in Section 1385(a) (1) & (2).[4] Further it should be noted that Congress failed to use the term "actually paid" when Section 404 was enacted.

The court of appeals attempts to justify its decision in a two-step process. First, it states that for the purposes of Section 404(a) accrual basis and cash basis taxpayers are in the same position. Second, proceeding from this incorrect premise the court draws on the cases of *Eckert* v. *Burnet*, 283 U.S. 140 and *Helvering* v. *Price*, 309 U.S. 409, which deal with deductions concerning cash basis taxpayers. Petitioner submits that the court's reliance on those cases is unwarranted because the sections of the Code construed

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[3] Petitioner submits the same argument applies to the court's reliance on the Treasury Regulations (Pet. for Cert., App. B, p. 15a).

[4] Internal Revenue Code of 1954 (26 U.S.C.): Section 1385. Amounts includible in patron's gross income.

(a) General rule.

Except as otherwise provided in subsection (b), each person shall include in gross income—

(1) the amount of any patronage dividend which is paid in money . . .,

(2) any amount, described in Section 1382(c) (2)(A) (relating to certain nonpatronage distributions by tax-exempt farmers' cooperatives), which is paid in money. . . .

and the issues involved in those cases were entirely different from those involved here. The statutory provisions considered in those two cases never use the word "paid" or "payment". The meaning of the words "charged off" and "sustained" in the statutory provisions interpreted in *Eckert* and *Price* cannot be controlling in the case at hand. It is true that the words "paid" and "payment" are found in these opinions, but Petitioner submits that they are only mentioned for the purpose of cash basis taxpayers. *Eckert* and *Price* cannot be said to stand for broad principles of Federal income tax law which would apply to accrual basis taxpayers. Cf. *Musselman Hub-Brake Co.* v. *United States, Supra,* 139 F.2d at 69.

Relying on prior judicial interpretations that it was not violating legislative policy, the Petitioner in this case acted in good faith to create an asset for the trust in each of the years to which this appeal relates. There was a change in positions since the trust assets increased and the Petitioner's net worth decreased. Petitioner has met the requirements of the congressional policy and is entitled to the deduction in furtherance of that policy.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals below should be reversed and an order entered allowing the deductions for contributions to the Profit Sharing Plan and disallowing any assessment of deficiencies for the taxable years ended April 30, 1967, April 30, 1968 and April 30, 1969.

Respectfully submitted,

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No. 75-1312

In the Supreme Court of the United States

October Term, 1976

Don E. Williams Company, petitioner
v.
Commissioner of Internal Revenue

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 75-1312

DON E. WILLIAMS COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Tax Court (Pet. App. 1a-12a) is reported at 62 T.C. 166. The opinion of the court of appeals (Pet. App. 13a-20a) is reported at 527 F. 2d 649.

JURISDICTION

The judgment of the court of appeals was entered on December 16, 1975 (Pet. App. 21a-22a). The petition for a writ of certiorari was filed on March 13, 1976, and was granted on June 7, 1976 (A.42). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

220-036—76——2

QUESTION PRESENTED

Whether an employer's issuance and delivery of its promissory note to the trustees of its employees' profit-sharing plan qualifies as a deductible "payment" to the plan within the meaning of Section 404(a) of the Internal Revenue Code of 1954, prior to the employer's actual payment of the note.

STATUTE AND REGULATION INVOLVED

The pertinent provisions of Section 404(a) of the Internal Revenue Code of 1954 (26 U.S.C.) and the Treasury Regulations on Income Tax (1954 Code), Section 1.404(a)-1 (26 C.F.R.), are set forth in the Appendix, *infra,* pp. 35–38.

STATEMENT

The pertinent facts were stipulated and may be summarized as follows: Petitioner is an Illinois corporation which serves as a manufacturers' representative and wholesaler for factory tools and supplies. It maintains its books and records and files its income tax returns in accordance with the accrual method of accounting and uses a taxable year ending April 30 (Pet. App. 2a).

Since 1964, petitioner has had a profit-sharing plan for its employees, which was qualified under Section 401(a) of the Internal Revenue Code of 1954. The trustees of the plan were the principal shareholders and officers of petitioner, Don E. Williams, Jr.,

Joseph W. Phillips, Jr., Alice R. Williams,[1] and the First National Bank of Moline (Pet. App. 2a; A. 15).

In the final days of its taxable years ending April 30, 1967, 1968, and 1969, petitioner's board of directors authorized contributions to its profit-sharing plan of $31,589.32, $34,333.26, and $35,337.86, respectively. Petitioner accrued these amounts as liabilities on its books at the close of each taxable year (Pet. App. 3a; Stip. pars. 11–27, A. 15–20).

During the month immediately following the accruals of these liabilities to the profit-sharing plan, petitioner delivered to the trustees of the plan its interest-bearing promissory note payable on demand in the face amount of the accrued liabilities. The notes issued by petitioner in 1967 and 1968 bore interest at six percent and the 1969 note bore interest at eight percent. The notes were guaranteed by the officers and principal shareholders of petitioner (who also served as trustees of the plan) and were secured by collateral consisting of stock of petitioner and the interests of two of the shareholders in the profit-sharing plan. It was stipulated that the value of the collateral plus the net worth of one of the guarantors exceeded the face amount of each note (Pet. App.

[1] The corporate offices and percentage of common stock ownership held by the trustees of the employees' profit-sharing plan were as follows: Don E. Williams, Jr.—president—87.08 percent; Joseph W. Phillips, Jr.—vice president—4.17 percent; and Alice R. Williams—secretary-treasurer—4.58 percent (Stip. par. 3, A. 14).

2a–3a, 14a; Stip. pars. 11–14, 16–20, 22–26, A. 16–20; Exs. 5–16, A. 20–41).

Petitioner subsequently paid these notes by delivering its checks to the trustees of the plan. The dates of issuance and amounts of petitioner's promissory notes and the dates and amounts of the checks petitioner delivered in payment of those notes are as follows (Pet. App. 3a; Stip. pars. 15, 21, 27, A. 17, 18, 20):

Date and amount of promissory note	*Date and amount of payment*
May 26, 1967—$31,589.32	April 4, 1968—$33,353.03 (includes interest of $1,763.71)
May 24, 1968—$34,333.26	April 28, 1969—$36,381.81 (includes interest of $2,048.55)
May 30, 1969—$35,337.86	March 31, 1970—$37,929.31 (includes interest of $2,591.45)

On its income tax returns for its taxable years ended April 30, 1967, 1968, and 1969, petitioner claimed deductions for the liabilities it accrued to the trustees of its employees' profit-sharing plan equal to the face amounts of the promissory notes it issued to the plan during the first months of the following taxable years. On audit, the Commissioner of Internal Revenue determined that petitioner's delivery of its promissory notes to the trustees of its profit-sharing plan did not constitute "payment" within the meaning of Section 404(a) of the Code. He accordingly disallowed the claimed deductions for the years in which petitioner accrued the liabilities in the face amounts of the notes and allowed deductions for those years only to the extent of petitioner's actual payments to the plan (Pet. App. 2a–3a).

In a reviewed decision with three dissents, the Tax Court adhered to its consistent series of rulings over

the past 25 years that an employer's contributions made to its employees' profit-sharing plan in the form of the employer's promissory note did not qualify as a deductible "payment" under Section 404(a) of the 1954 Code and its predecessor provision under the 1939 Code (Pet. App. 1a–12a). The Tax Court accordingly upheld the Commissioner's determination of deficiencies against petitioner totalling $17,053.93 for the years at issue (A. 42).

The court of appeals unanimously affirmed (Pet. App. 13a–20a). It concluded that the language of the statute, the legislative history, the Treasury Regulations, and the decisions of this Court sustain the Commissioner's position that the statutory term "payment" means that the employer must make actual payment to a profit-sharing plan in cash or its equivalent and not by the issuance of its promissory note (Pet. App. 17a–20a).

SUMMARY OF ARGUMENT

A.

Section 404(a) of the Internal Revenue Code permits a deduction for contributions "paid" by an employer to its employees' profit-sharing plan "[i]n the taxable year when paid * * *." During the taxable years at issue, petitioner accrued liabilities to its employees' plan and delivered its secured demand promissory notes to the plan after the close of those taxable years but before it filed its returns. However, petitioner did not pay its obligations represented by the notes until almost one year after their issuance.

Under these circumstances, the Tax Court and the court of appeals correctly held that the issuance and delivery of a promissory note by an employer to its employees' profit-sharing plan is not a deductible "payment" to the plan under Section 404(a).

The language and structure of Section 404(a) establish that an employer must actually "make" a "payment" to the plan during the taxable year in order to qualify for the deduction. This is evidenced by the use of the term "paid" in the statute rather than the "paid or accrued" formulation found in other deduction provisions of the Code. The only exception to the actual payment rule is the grace period applicable to accrual basis taxpayers during the years at issue permitting "payment" to be made prior to the filing of the return.

Petitioner does not deny that Section 404(a) requires more than a mere accrual of a liability but argues that the issuance of its secured promissory notes qualified as actual payments of its contributions. But the legislative history of Section 404(a) demonstrates that it was well understood that the statute placed all taxpayers on the cash basis with respect to their payments to employee plans, regardless of their method of accounting. This policy is likewise reflected in the Treasury Regulations, which have been outstanding for over 30 years. Thus, Section 404(a) conditions the deduction upon the making of an actual disbursement in cash or its equivalent.

This case is therefore controlled by this Court's decisions in *Eckert* v. *Burnet,* 283 U.S. 140, and

Helvering v. *Price,* 309 U.S. 409. In both of those cases, the Court recognized that a taxpayer's giving of his own promissory note was not sufficient to warrant a deduction for payment until the promise to pay represented by the note was made good by actual payment. Here, too, petitioner's giving of its notes does not entitle it to a deduction for a contribution to its employees' plan because "[i]f the note is never paid, [it] has parted with nothing more than [its] promise to pay." *Hart* v. *Commissioner,* 54 F. 2d 848, 852 (C.A. 1).

The fact that petitioner's notes were secured does not warrant a different result. As this Court stated in *Helvering* v. *Price, supra,* 309 U.S. at 414, "the giving of security for performance did not transform the promise into the payment required to constitute a deductible loss in the taxable year." Since petitioner parted with none of its assets upon the issuance of its promissory notes, it is not entitled to a deduction under a statute that requires an actual payment.

B.

The foregoing analysis is in accord with a consistent line of decisions of the Tax Court of more than 25 years' duration. However, three courts of appeals have held that an employer's issuance and delivery of a promissory note to its employees' plan qualifies as a deductible payment.

These decisions rest on two incorrect premises. First, they erroneously assume that the meaning of the term "paid" in Section 404(a) is the same as in

Section 267(a) of the Code. That latter provision disallows deductions by accrual basis taxpayers for accrued and unpaid interest and expenses that its closely related cash basis payee would not include in income. The legislative history of Section 267(a) indicates that Congress intended the word "paid" to have a special meaning in that provision in order to insure symmetrical tax treatment between a payor and its related payee. Thus, if an accrual basis payor issued a note to its related cash basis payee, there was no need to bar the payor's claim to a deduction as long as the payee included the corresponding amount in income. However, these considerations of symmetry have no application here because a qualified employees' profit-sharing plan is exempt from tax so that the employer's contributions are not taxed to the plan.

Secondly, those decisions rely upon the mistaken notion that a demand promissory note is the equivalent of a check. Because checks have replaced currency as the predominant medium of exchange, their delivery is treated as the payment of cash for federal tax purposes. But as this Court's *Eckert* and *Price* decisions demonstrate, promissory notes are not considered payment for tax purposes but merely constitute a promise to pay.

Finally, although the determination of what constitutes payment under the Internal Revenue Code is a question of federal law, the rule we urge in this case is consistent with the law of all of the states, as set forth in the Uniform Commercial Code, that a

promissory note is not payment of an obligation or the equivalent of a check.

ARGUMENT

THE ISSUANCE AND DELIVERY OF A PROMISSORY NOTE BY AN EMPLOYER TO ITS EMPLOYEES' PROFIT-SHARING PLAN DOES NOT QUALIFY AS A DEDUCTIBLE "PAYMENT" TO THE PLAN UNDER SECTION 404(a) OF THE INTERNAL REVENUE CODE

A. INTRODUCTION

This federal income tax case involves an issue relating to the administration of qualified employee pension and profit-sharing plans. The question presented, upon which the courts of appeals have divided, is whether an employer's issuance and delivery of its promissory note to its employees' profit-sharing plan qualifies as a deductible "payment" to the plan within the meaning of Section 404(a) of the Internal Revenue Code of 1954. We submit that both the Tax Court (Pet. App. 1a–12a) and the court of appeals (Pet. App. 13a–20a) correctly answered this question negatively.

Section 404(a) of the Internal Revenue Code of 1954, Appendix, *infra*, p. 35, provides that "[i]f contributions are paid by an employer to * * * a * * * profit-sharing * * * plan," the contributions shall be deductible "[i]n the taxable year when paid * * *." Section 404(a)(6) establishes a special rule for accrual basis taxpayers who make such contributions. It states that "a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of

such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof)."

Here, petitioner, an accrual basis taxpayer, accrued liabilities to its employees' profit-sharing plan prior to the close of its three taxable years at issue and delivered its promissory notes to the plan after the close of those taxable years but prior to the time it was required to file its returns for those years. Pursuant to Section 6072(b) of the Code, a corporation is required to file its income tax return on or before two and one-half months after the close of its taxable year. Since petitioner's taxable year ended April 30, it could have made a "payment" under Section 404 (a)(6) on or before July 15 that would have been deductible for the preceding taxable year.

Thus, if petitioner had paid its accrued liabilities to the plan at the times it delivered its promissory notes to the trustees, it would have come within the special rule of Section 404(a)(6) that enables accrual basis taxpayers to deduct such contributions for the preceding taxable year as long as they are paid prior to the filing of its return for that year.

But petitioner did not "pay" the amounts of the accrued liabilities to its employees' profit-sharing plan. Instead, it delivered its promissory notes which it did not pay until after it filed its returns for the years in which it accrued the corresponding liabilities and claimed deductions. Petitioner therefore did not suffer a reduction in its net assets during the taxable years for which it claimed deductions.

The language of the statute and its legislative history, to which we now turn, show that the payment requirement of Section 404(a) is not met by the issuance and delivery of a promissory note.

B. THE LANGUAGE OF SECTION 404(a) AND ITS LEGISLATIVE HISTORY DEMONSTRATE THAT ONLY ACTUAL PAYMENT BY AN EMPLOYER TO ITS EMPLOYEES' PROFIT-SHARING PLAN IS DEDUCTIBLE

1. The statutory language and structure

Pursuant to Section 446(c) of the 1954 Code,[2] both the cash receipts and disbursements method and the accrual method are permissible methods of accounting for computing taxable income. Under the cash method, a taxpayer must include in income those items which he has actually received or which are available for his receipt. A cash basis taxpayer can deduct only those expenses which he has actually paid out during the taxable year. Conversely, under the accrual method, a taxpayer must include in income those items to which he has a presently enforceable contractual right of receipt, notwithstanding the fact that he may actually receive them in a subsequent taxable year. With respect to expenses, an accrual basis taxpayer may claim deductions for those items which he is presently obligated to pay notwithstanding the fact that he may in fact make actual disburse-

[2] The prior statute, Section 41 of the 1939 Code (26 U.S.C. 1952 ed.), provided that a taxpayer was to compute his net income "in accordance with the method of accounting regularly employed" in keeping his books. Approved standard methods of accounting were permitted as long as they clearly reflected income. See Treasury Regulations 111, Section 29.41-1 (1939 Code).

ment in a subsequent taxable year. See *United States* v. *Anderson*, 269 U.S. 422, 438-441; *Spring City Foundry Co.* v. *Commissioner*, 292 U.S. 182, 184-185.

In recognition of these two permissible methods of accounting, Congress has employed the term "paid or accrued" or "paid or incurred" in many of the deduction provisions of the Code.[3] The use of either of these terms evidences Congress' intention to permit accrual basis taxpayers to deduct these accrued but unpaid items.[4] However, with respect to deductible contributions to employee pension and profit-sharing plans, Congress did not use the term "paid or accrued." Instead, it provided in Section 404(a) that such contributions shall be deductible by the employer "[i]n the taxable year when *paid* * * *" (emphasis supplied).

The use of the term "paid" imposes the requirement of actual payment rather than simply the recognition (accrual) of a liability to make payment. This is confirmed by the special rule for accrual basis taxpayers set forth in Section 404(a)(6). That rule, as we have noted *supra*, pp. 9-10, provides that an accrual basis taxpayer shall be deemed to have made a payment to

[3] See, *e.g.*, Sections 162(a) (trade or business expenses); 163(a) (interest); 164(a) (taxes); 174(a)(1) (research and experimental expenses); 175(a) (soil and water conservation expenses); 177(a) (trademark and trade name expenses); 180(a) and 182(a) (farm expenses); 212 (expenses for the production of income); 216(a) (cooperative housing expenses); and 217 (moving expenses).

[4] See Section 7701(a)(25) of the Code, which provides that "[t]he terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the taxable income is computed under subtitle A."

the plan on the last day of the year of accrual *"if the payment * * * is made* not later than the time prescribed by law for filing the return for such taxable year * * *" (emphasis supplied). If an employer's accrual of a liability to its employees' plan were sufficient to justify a deduction, there would be no need for the special grace period rule applicable to accrual basis taxpayers.

Thus, the terms and structure of Section 404(a) establish that an employer must actually "make" a "payment" to its employees' plan in order to qualify for a deduction. Petitioner does not deny that the statute requires more than a simple accrual of the employer's liability to the plan. The only question therefore is what constitutes "actual payment" under the statute.

The legislative history demonstrates that Congress intended to condition the deduction upon the actual payment of cash or its equivalent; the issuance of a promissory note would not constitute a deductible payment under the statute. Indeed, each time Congress has considered these statutes since their original enactment, it has reaffirmed the requirement of actual payment in cash or its equivalent.

2. The legislative history

Section 404 of the 1954 Code is virtually identical to its original predecessor, Section 23(p) of the 1939 Code, which was first enacted as Section 162(b) of the Revenue Act of 1942, 56 Stat. 863. The pertinent Committee Reports refer to the "actual payment"

requirement of the statute as applicable to accrual basis taxpayers. Both the House and Senate Committees stated: "[i]f an employer on the accrual basis defers paying any compensation to the employee until a later year or years under an arrangement having the effect of a stock bonus, pension, profit-sharing, or annuity plan or similar plan deferring the receipt of compensation, he will not be allowed a deduction until the year in which the compensation is paid." H.R. Rep. No. 2333, 77th Cong., 2d Sess. 106 (1942); S. Rep. No. 1631, 77th Cong., 2d Sess. 141 (1942).[5]

The imposition of an actual payment rule for contributions to employee plans presented a computational problem for accrual basis taxpayers who wished to make the maximum contribution to their employees' plan under the percentage limitations provisions of the statute but who would not be able to ascertain that figure until after the close of the taxable year. Other accrual basis employers expressed concern about making a contribution that would not be deductible against the current year's earnings. See Senate Hearings before the Committe on Finance

[5] The limitation of the actual payment requirement to contributions to employee plans is evidenced by the sentence in the Committee Reports immediately following the sentence quoted in the text. That sentence states: "This provision is not intended to cover the case where an employer on an accrual basis defers payment of compensation after the year of accrual merely because of inability to pay such compensation in the year of accrual." See H.R. Rep. No. 2333, *supra*; S. Rep. No. 1631, *supra*. Thus, in the case of ordinary compensation, an accrual basis taxpayer could claim a deduction for accrued but unpaid items under Section 162(a) of the Code, which employs the "paid or incurred" formulation.

on the Revenue Act of 1942, 77th Cong., 2d Sess. 465 (1942). Accordingly, the Senate Finance Committee added the grace period for accrual basis taxpayers now set forth in Section 404(a)(6) of the Code. As originally enacted, Section 23(p)(1)(E) of the 1939 Code provided for a 60-day period after the close of the taxable year within which an accrual basis taxpayer could make a contribution that would be deductible for the preceding year.

For purposes of this case, the significant aspect of the addition of the grace period for accrual basis taxpayers is that both Congress and taxpayers alike recognized that the statute in effect placed all employers on the cash basis method for purposes of eligibility for deductions to employee pension or profit-sharing plans. In urging the Senate Finance Committee to adopt a grace period for accrual basis taxpayers in order to eliminate the difficulty of determining the proper contribution figure prior to the close of the taxable year, one witness stated that "[e]ven if you qualify * * * [as a tax-exempt profit-sharing plan], the law has been drafted in such a way that all corporations are put on a cash basis on the payment to trusts." See Statement of Richard D. Sturtevant, Assistant Secretary, Jewel Tea Co., Inc., Senate Hearings before the Committee on Finance on the Revenue Act of 1942, 77th Cong., 2d Sess. 455, 465 (1942).

Thus, whatever the employer's method of accounting, it was well understood at the time of the original enactment of what is now Section 404(a) of the Code

that the statute conditioned qualification for a deduction for a contribution to its employee plan upon the making of an actual disbursement in cash or its equivalent. The only exception to this cash basis rule was that an accrual basis employer had an additional 60 days after the close of the taxable year within which to make payment to the plan.[6]

This congressional understanding of the requirement of actual payment was reaffirmed six years after the enactment of the statute. In 1948, the House of Representatives recommended an extension of the grace period applicable to accrual basis taxpayers. Although the Senate declined to do so at that time, the House Committee Report observed that the statute provided that: "[a]n employer on the accrual basis of accounting may under existing law deduct contributions *actually paid* within the first 60 days of the subsequent year." H.R. Rep. No. 2087, 80th Cong., 2d Sess. 13 (1948) (emphasis supplied).

[6] Petitioner correctly notes (Br. 16) that Section 1013(c)(2) of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 88 Stat. 923, has amended Section 404(a)(6) of the Code to give cash basis taxpayers the benefit of the grace period within which to make a contribution to an employee plan. See H.R. Rep. No. 93-807, 93d Cong., 2d Sess. 101, 118 (1974); S. Rep. No. 93-383, 93d Cong., 1st Sess. 127-128 (1973); H.R. Conf. Rep. No. 93-1280, 93d Cong., 2d Sess. 347 (1974); Hearings on Private Pension Plans before a Subcommittee of the Senate Finance Committee (Part I), 93d Cong., 1st Sess. 210, 315, 508, 588, 605, 616 (1973). But the extension of the grace period to cash basis taxpayers does not, as petitioner suggests (Br. 16), support its argument that the giving of a promissory note qualifies as a deductible "payment." The amendment simply permits all taxpayers an additional period after the close of the taxable year within which to make an actual payment in cash or its equivalent.

Finally, in extending the 60-day grace period in 1954 to the time prescribed for filing the tax return for the year of accrual (generally two months and 15 days after the close of the taxable year),[7] Congress reaffirmed the "actual payment" requirement for all taxpayers regardless of their method of accounting. See S. Rep. No. 1622, 83d Cong., 2d Sess. 55, 292 (1954); H.R. Rep. No. 1337, 83d Cong., 2d Sess. A151 (1954).

The foregoing excerpts from the legislative history of Section 404(a) demonstrate that on three separate occasions Congress evidenced its intention to impose an "actual payment" rule for deductible contributions to employee plans. This requirement of actual payment is likewise reflected in the pertinent Treasury Regulations issued contemporaneously with the enactment of the statute. Thus, Section 1.404(a)-1(c) of the present Treasury Regulations, which are substantially identical to the Regulations issued under Section 23(p) of the 1939 Code,[8] provides:

> *Deductions under section 404(a) are generally allowable only for the year in which the contribution or compensation is paid, regardless of the fact that the taxpayer may make his returns on the accrual method of accounting.* * * * This latter provision [Section 404(a)

[7] Section 6072(b) of the Code provides that corporate returns made "on the basis of a fiscal year shall be filed on or before the 15th day of the third month following the close of the fiscal year." See p. 10, *supra*.

[8] See Treasury Regulations 111, Section 29.23(p)-1 (1939 Code); Treasury Regulations 118, Section 39.23(p)-1(d) (1939 Code).

(6)] is intended to permit a taxpayer on the accrual method to deduct such accrued contribution or compensation in the year of accrual, *provided payment is actually made* not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof) * * *. [Emphasis supplied.]

As a contemporaneous construction of the statute, these Regulations are entitled to great weight. See, *e.g.*, *Bingler* v. *Johnson*, 394 U.S. 741, 749–750; *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501. Moreover, since the promulgation of the Regulations under the 1942 Act embodying the "actual payment" requirement, Congress reenacted the statute without substantial change at the time of the 1954 codification. Under the long-standing decisions of this Court, the administrative construction of the statutory term "paid" as meaning "actual payment" is therefore deemed to have received congressional approval and to have the force of law. See, *e.g.*, *Lykes* v. *United States*, 343 U.S. 118, 127; *Helvering* v. *Winmill*, 305 U.S. 79, 83; *Morrissey* v. *Commissioner*, 296 U.S. 344, 355; *Brewster* v. *Gage*, 280 U.S. 327, 337.

C. *ECKERT* V. *BURNET*, 283 U.S. 140, AND *HELVERING* V. *PRICE*, 309 U.S. 409, ESTABLISH THAT DELIVERY OF A SECURED PROMISSORY NOTE DOES NOT CONSTITUTE "ACTUAL PAYMENT" OF AN OBLIGATION

1. Since Section 404(a) puts all taxpayers on the cash basis method of accounting by requiring actual payment of the contribution, petitioner is subject to the rule governing cash basis taxpayers. As the court

of appeals correctly recognized (Pet. App. 15a–16a), two decisions of this Court establish that the issuance of a promissory note by a cash basis taxpayer does not constitute "payment" for federal tax purposes.

In *Eckert* v. *Burnet*, 283 U.S. 140, the Court unanimously held that the endorser of the note of an insolvent maker could not claim a bad debt deduction upon taking up the note and substituting one of his own notes to the creditor. There, the Court stated, in quoting from the opinion of the Board of Tax Appeals with approval, that the taxpayer "merely exchanged his note under which he was primarily liable for the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value" (283 U.S. at 141; 17 B.T.A. at 266). "A deduction," as the Court observed, "may be permissible in the taxable year in which the [taxpayer] pays cash" (283 U.S. at 141–142).

Similarly, in *Helvering* v. *Price*, 309 U.S. 409, the Court on the authority of *Eckert* rejected the argument, advanced again by petitioner here (Br. 13), that the delivery of a secured note in satisfaction of an obligation gave rise to a tax deduction. First, the Court recognized that "under the doctrine of the *Eckert* case the giving of the taxpayer's own note was not the equivalent of cash to entitle the taxpayer to the deduction" (309 U.S. at 413). Second, the Court concluded that the fact that the promissory note was secured, as here, does not warrant a different result. It stated: "the collateral was not payment. It was given to secure [the] promise to pay, and if [the]

promise to pay was not sufficient to warrant the deduction until the promise was made good by actual payment, the giving of security for performance did not transform the promise into the payment required to constitute a deductible loss in the taxable year" (309 U.S. at 413–414).

Here, too, petitioner's giving of its notes, although secured, does not entitle it to a deduction for a contribution to its employees' plan because "[i]f the note is never paid, [it] has parted with nothing more than [its] promise to pay." *Hart* v. *Commissioner,* 54 F. 2d 848, 852 (C.A. 1).[9] See also *Page* v. *Rhode Island Hospital Trust Co.,* 88 F. 2d 192 (C.A. 1).

Petitioner does not challenge the *Eckert-Price* rule but argues (Br. 17) that it is inapplicable to an accrual basis taxpayer and that such a taxpayer can make a deductible "payment" by giving its promissory

[9] Contrary to petitioner's argument (Br. 17–18), the scope of the *Eckert* rule is not limited to the bad debt deduction at issue in that case. Indeed, the Court in *Price* (309 U.S. at 411–412) specifically rejected the court of appeals' similar suggestion (106 F. 2d at 340), noting that "[t]he reasoning of this Court was broad enough to cover both aspects of the case" (309 U.S. at 413). It is therefore understandable that the lower courts have applied the principle established in *Eckert* and *Price* in denying a variety of claimed deductions. See, *e.g., Cleaver* v. *Commissioner,* 158 F. 2d 342 (C.A. 7), certiorari denied, 330 U.S. 849 (giving of note is not interest "paid" for purpose of the interest deduction); *Jenkins* v. *Bitgood,* 101 F. 2d 17 (C.A. 2) (giving of note is not actual payment for purposes of the loss deduction); *Baltimore Dairy Lunch, Inc.* v. *United States,* 231 F. 2d 870, 875 (C.A. 8) (same); *Guren* v. *Commissioner,* 66 T.C. 118 (delivery of a demand promissory note is not a deductible "payment" of a contribution to a charity); *Petty* v. *Commissioner,* 40 T.C. 521, 524 (Atkins, J., concurring) (same). See also Rev. Rul. 68–174, 1968–1 Cum. Bull. 81.

note. But the statutory terms "paid" and "payment," coupled with the grace period provision and the repeated references in the legislative history to "actual payment," demonstrate that all taxpayers, regardless of their method of accounting, are required to pay out cash or its equivalent within the taxable year or the grace period in order to qualify for the Section 404(a) deduction. "The ordinary and usual meaning of 'paid' is to liquidate a liability in cash." *P. G. Lake, Inc.* v. *Commissioner,* 148 F. 2d 898, 900 (C.A. 5), certiorari denied, 326 U.S. 732. It is a "firmly established principle of tax law that the ordinary meaning of terms is persuasive of their statutory meaning" (*Commissioner* v. *Korell,* 339 U.S. 619, 627–628); there is no indication that Congress intended to depart from this ordinary meaning of the term "paid."[10]

[10] Petitioner argues (Br. 17) that if Congress intended a "liquid form of payment," it would have employed the term "paid in money" as it did in Section 1385(a) of the Code. But since an employer can qualify for a deduction for a contribution to a pension plan by a transfer of property other than money as long as the transfer represents an outlay of assets, the use of the term "paid in money" in Section 404(a) would have been inappropriate. See *Colorado National Bank of Denver* v. *Commissioner,* 30 T.C. 933, holding that a transfer of realty was a "payment" under Section 404(a).

Moreover, the specific list of items set forth in Section 1385(a), dealing with the special tax treatment of cooperatives, was intended to remedy the confusing state of prior decisional law with respect to what items were includable in the gross income of the patron of a cooperative. See H.R. Rep. No. 1447, 87th Cong., 2d Sess. 78–82 (1962); S. Rep. No. 1881, 87th Cong., 2d Sess. 111–117 (1962). The terms of that provision therefore offer no useful analogy to Section 404(a).

To the contrary, in imposing the requirement of actual payment, Congress chose to establish a uniform and objective outlay-of-assets test which would insure that the employees' plan would maintain its liquidity and eliminate the need for the Internal Revenue Service to make an open-ended inquiry into an unlimited number of future years in order to ascertain whether the employer's obligation to its employees' plan was in fact ever paid in a subsequent taxable year.[11] Thus, for purposes of Section 404(a), all taxpayers are placed on the cash method of disbursements to which the *Eckert-Price* rule is applicable. Since

[11] A similar policy of actual payment is applicable to Section 170(a) of the Code, which permits a deduction for "any charitable contribution * * * *payment* of which is *made* within the taxable year" (emphasis supplied). In employing this language, which first appeared in Section 23(o) and (q) of the Revenue Act of 1938, 52 Stat. 463, 464, the pertinent Committee stated (H.R. Rep. No. 1860, 75th Cong., 3d Sess. 19 (1938)):

"[T]he deduction for contributions or gifts for charitable and other purposes shall be allowed only for the taxable year in which the contribution is *actually paid* regardless of whether the taxpayer is reporting income on the cash or the accrual basis. The allowance of the deduction in the year when *actually paid* will provide a clearer rule without hardship to the taxpayer and will eliminate the uncertainty in the administration of the deduction." (Emphasis supplied.)

See *Petty* v. *Commissioner*, 40 T.C. 521; *Guren* v. *Commissioner*, 66 T.C. 118. The parallel between Sections 170 and 404(a) of the Code is further illustrated by Section 170(a)(2), which provides that a corporation reporting its income on the accrual basis may deduct a charitable contribution accrued during the taxable year as long as it is "made" within two and one-half months following the close of the taxable year. This grace period is analogous to Section 404(a)(6), which originally applied to accrual basis taxpayers but now applies to all taxpayers.

petitioner parted with none of its assets upon the issuance of its promissory notes, it is not entitled to a deduction under a statute that requires an actual payment.[12]

Finally, in implicit recognition that the actual payment requirement of Section 404(a) was not satisfied by the issuance of its promissory notes, petitioner attempts (Br. 13–14) to recast the transaction to a payment of cash by it to the employees' plan followed by a loan from the plan to petitioner in the amount of the cash advance. But this argument "would require rejection of the established tax principle that a transaction is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred." *Commissioner* v. *National Alfalfa Dehydrating*, 417 U.S. 134, 148. See also *Cen-*

[12] Petitioner argues (Br. 12) that "[t]he important issue is whether something of value was transferred by the contributor." Since its notes had value, petitioner urges that it is entitled to a deduction equal to the value of the notes.

Where property is sold or exchanged for notes, the notes are taken into income of the recipient at their fair market value. *Pinellas Ice Co.* v. *Commissioner*, 287 U.S. 462, 469. But it does not follow that a maker's notes must be treated as the equivalent of cash for purposes of determining whether he has made a deductible "payment" by delivery of them. While the note in the recipient's hands can be sold or negotiated, the note in the maker's hands, even if fully secured as in this case, is merely his promise to pay and does not represent a current outlay of cash or other property. See *Jenkins* v. *Bitgood*, *supra*, 101 F. 2d at 19, cited with approval by this Court in *Helvering* v. *Price*, *supra*, 309 U.S. at 414. Indeed, the taxpayer in *Helvering* v. *Price*, 309 U.S. 409, similarly argued that his notes had value in the hands of the recipient. See Brief for the Petitioner, No. 559, October Term, 1939, pp. 16–17.

tral Tablet Mfg. Co. v. *United States*, 417 U.S. 673, 690.[13]

Moreover, petitioner's indirect loan analogy, as well as the very transaction in this case, would have severely adverse consequences under Section 2003(a) of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 88 Stat. 971. Pursuant to that provision, an employer's issuance of its promissory note to an employee plan is a "prohibited transaction" subject to a five-percent penalty in the amount of the loan. See Section 4975(a) and (c)(1)(B) of the Code. As the pertinent Committee Report states (H.R. Conf. Rep. No. 93-1280, 93d Cong., 2d Sess. 308 (1974):

> It is intended that prohibited loans include the acquisition by the plan of a debt instrument (such as a bond or note) which is an obligation of a party-in-interest. * * * Similarly, it is intended that it would be a prohibited transaction (in effect a loan by the plan to the employer) if the employer funds his contributions to the plan with his own debt obligations.

If the prohibited transaction is not corrected within a prescribed period, there is an additional penalty imposed equal to 100 percent of the amount involved. See Section 4975(b) of the Code. As matters now stand, an employer, like petitioner, which issues its promissory note as a contribution to an employee

[13] Significantly, the court of appeals in *Price* v. *Commissioner*, 106 F. 2d 336, 339 (C.A. 4), reversed *sub nom. Helvering* v. *Price*, 309 U.S. 409, relied upon the same loan analogy.

plan will not only fail to qualify for a deduction but will also be subject to a penalty for a prohibited transaction. Thus, by imposing such a penalty, Congress has again reaffirmed the actual payment requirement of Section 404(a) and strengthened its enforceability.[14]

2. In accordance with the foregoing analysis of the language of Section 404(a) and its legislative history, the Tax Court has consistently upheld the Commissioner's position that the delivery of a note is not a deductible "payment" within the meaning of Section 404(a) or its substantially identical predecessor, Section 23(p) of the 1939 Code.[15] In the Tax Court's view, the statute puts accrual and cash basis taxpay-

[14] Although petitioner acknowledges that the giving of its notes would be a prohibited transaction under ERISA, it contends (Br. 11) that the penalty provisions of ERISA have mooted the question presented. But there is still a live controversy between the parties as to the correctness of the Commissioner's determination of deficiencies against petitioner. The question therefore is not moot. See *J. Aron & Co.* v. *Mississippi Shipping Co.*, 361 U.S. 115; *Stewart* v. *Southern Railway Co.*, 315 U.S. 283, 284.

Moreover, while the enactment of ERISA diminishes the importance of the question for taxable periods beginning after the effective date of the penalty provisions (January 1, 1975), there is still a conflict of decisions for pre-ERISA years with respect to which there are 116 cases pending administratively with $3,675,000 of taxes at stake. (See Memorandum for the Respondent, p. 7.) At all events, the negative impact of the new legislation upon the importance of the question presented would call for dismissal of the writ of certiorari as improvidently granted, rather than the reversal of the court of appeals sought by petitioner in this case. See *Rudolph* v. *United States*, 370 U.S. 269.

[15] *Logan Engineering Co.* v. *Commissioner*, 12 T.C. 860; *Freer Motor Transfer Co.* v. *Commissioner*, 8 T.C.M. 507; *Sachs* v. *Com-*

ers upon the same footing with respect to what constitutes payment; payment means the liquidation of a liability in cash or its equivalent for all taxpayers, regardless of their method of accounting; and the delivery of a promissory note issued by an employer to his employees' plan is only a promise to pay and not actual payment.

Three courts of appeals, however, have held that the contribution of promissory notes to profit-sharing plans qualified as a deductible "payment" under Section 404(a) or its predecessor provision. See *Sachs* v. *Commissioner,* 208 F. 2d 313 (C.A. 3) (demand promissory note payable at a bank); *Time Oil Co.* v. *Commissioner,* 258 F. 2d 237 (C.A. 9) (noninterest-bearing promissory note); and *Wasatch Chemical Co.* v. *Commissioner,* 313 F. 2d 843 (C.A. 10) (five-year unsecured promissory note). Accord: *Advance Construction Co., Inc.* v. *United States,* 356 F. Supp. 1267 (N.D. Ill.).

These decisions, upon which petitioner relies (Br. 9-10), stand on two erroneous grounds. First, they assume that the term "paid" in Section 404(a) has

missioner, 11 T.C.M. 882, reversed, 208 F. 2d 313 (C.A. 3); *Slaymaker Lock Co.* v. *Commissioner*, 18 T.C. 1001, reversed *sub nom. Sachs* v. *Commissioner*, 208 F. 2d 313 (C.A. 3); *Time Oil Co.* v. *Commissioner*, 26 T.C. 1061, remanded, 258 F. 2d 237 (C.A. 9), supplemental opinion, 294 F. 2d 667 (C.A. 9); *Wasatch Chemical Co.* v. *Commissioner*, 37 T.C. 817, reversed, 313 F. 2d 843 (C.A. 10); *Patmon, Young & Kirk* v. *Commissioner*, 34 T.C.M. 798, affirmed, 536 F.2d 142 (C.A. 6); *Lancer Clothing Corp.* v. *Commissioner*, 34 T.C.M. 776, appeal pending, C.A. 2, No. 76-4012; *Coastal Electric Corp.* v. *Commissioner*, 34 T.C.M. 1007, appeal pending, C.A. 4, No. 75-2184.

the same meaning as in Section 267(a), which disallows certain deductions by accrual basis taxpayers of accrued but unpaid items to related cash basis payees. Second, they treat the delivery of a demand note as equivalent to the giving of a check.

a. The mistaken analogy between Sections 404(a) and 267(a) derives primarily from two decisions—*Anthony P. Miller, Inc.* v. *Commissioner,* 164 F. 2d 268 (C.A. 3), and *Musselman Hub-Brake Co.* v. *Commissioner,* 139 F. 2d 65 (C.A. 6). These cases respectively held that accrual basis corporations' delivery of their demand note to an officer for salary and to a controlling shareholder for royalties and interest "paid" these items within the meaning of Section 24(c) of the 1939 Code (the predecessor of Section 267(a)), which disallowed such expenses unless they are "paid" within two and one-half months after the close of the taxable year.[16]

But these decisions made clear that the meaning of the term "paid" in what is now Section 267(a) turned on the specific purpose of that statute to prevent tax avoidance by barring an accrual basis payor from claiming a deduction for an accrued but unpaid item that its closely related cash basis payee would not include in income until paid. See H.R. Rep. No. 1546, 75th Cong., 1st Sess. 29 (1937); S. Rep. No. 1242, 75th Cong., 1st Sess. 31 (1937). Because the recipients

[16] Petitioner relies (Br. 7-8) upon *Celina Mfg. Co.* v. *Commissioner*, 142 F. 2d 449 (C.A. 6), *Commissioner* v. *Mundet Cork Corp.*, 173 F. 2d 757 (C.A. 2), and *Akron Welding & Spring Co.* v. *Commissioner*, 10 T.C. 715, which are to the same effect.

of the promissory notes in those cases were required to include the fair market value of the notes in income at the time of receipt, the courts concluded that the policy of Section 267 would not be served by disallowing the deduction to the payor. As the Sixth Circuit observed in *Musselman Hub-Brake Co.* v. *Commissioner, supra*, 139 F. 2d at 68:

> [I]f the debtor credited to the account of the creditor sums under circumstances which would require reporting income constructively received or the creditor received property, either tangible or intangible having a cash value equal to the deduction claimed by the debtor, *the deduction would be allowable under the statute, because the creditor would be required to include these sums in his gross income.* [Emphasis supplied.]

See also *Logan Engineering Co.* v. *Commissioner*, 12 T.C. 860, 868.

The fact that Section 267 turns on considerations of symmetry of tax treatment between an accrual basis taxpayer and its related cash basis payee is further confirmed by the 1953 amendment to its predecessor provision, Section 24(c) of the 1939 Code. Section 202(a) of the Technical Changes Act of 1953, 67 Stat. 617, now set forth in Section 267(a)(2)(A) of the present Code, amended the statute to provide that the payor of interest or expenses could claim a deduction for those items as "paid" if the related payee is required to include them in income by application of the doctrine of constructive receipt during the payor's taxable year or within two and one-half months thereafter. See H.R. Rep. No. 894, 83d Cong., 1st Sess. 13

(1953); S. Rep. No. 685, 83d Cong., 1st Sess. 4 (1953); 96 Cong. Rec. A1979 (1950); 99 Cong. Rec. 11068-11069 (1953). The legislative history therefore demonstrates that Congress used the term "paid" in Section 267 in a special sense to insure that transactions between related persons receive consistent tax treatment.

However, these considerations of symmetry have no application to Section 404(a), which permits an employer to deduct contributions "paid" to an employee pension or profit-sharing plan. Pursuant to Sections 401(a) and 501(a), a qualified employee plan is exempt from tax. Thus, the policy of Section 267 has no relevance to what constitutes "payment" to an employee plan, because the employer's contributions are not taxed to the plan.[17] See Rev. Rul. 55-608, 1955-2 Cum. Bull. 546, 548; Rev. Rul. 71-95, 1971-1 Cum. Bull. 130.

b. The decisions of the Third, Ninth, and Tenth Circuits erroneously equate promissory notes with checks for federal tax purposes. Checks have replaced currency as the predominant medium of exchange and their delivery is therefore generally treated as the payment of cash for federal tax purposes. *Estate of Spiegel* v. *Commissioner,* 12 T.C. 524, acq., 1949-2 Cum. Bull. 3; Rev. Rul. 54-465, 1954-2 Cum. Bull. 93.

[17] The policy of symmetrical tax treatment is likewise inapplicable to Section 170(a), which allows a deduction for "payment" of contributions to qualified charities. As in the case of an employee plan, a qualified charitable organization is exempt from tax. Thus, Section 170 similarly requires actual payment in cash or its equivalent in order to qualify for a charitable contribution deduction. See pp. 22-23, n. 11, *supra*.

But as this Court's *Eckert* and *Price* decisions demonstrate, promissory notes, even fully secured demand notes as in this case, are not considered to be payment for tax purposes, but merely constitute a promise to pay. Indeed, the facts of this case demonstrate that promissory notes are not the equivalent of checks because petitioner systematically paid off its notes with checks eleven months after issuing the notes (A. 17, 18, 20). Given the fact that three of the four trustees of the employees' profit-sharing plan were petitioner's principal officers and shareholders, it is unrealistic to attribute any significance to the fact that petitioner's promissory notes were payable on "demand."

3. Although the determination of what constitutes payment under the Internal Revenue Code is a question of federal law (cf. *Morgan* v. *Commissioner,* 309 U.S. 78), the Uniform Commercial Code, now applicable in all of the states and the District of Columbia, distinguishes between checks and promissory notes and provides that promissory notes do not constitute payment. See 1 Anderson, *Uniform Commercial Code*, pp. ix–x (2d ed. 1970); 2 Anderson, *supra,* p. 596; La. Stat. Ann., Rev. Stat., Sections 10:1-101, 10:3-104 *et seq.* (1976 Supp.). The uniform rule, as represented by the Illinois law involved in this case, is that a check is a draft drawn on a bank and payable on demand, while a note is only a promise to pay. Section 3-104(2), Ill. Ann. Stat., c. 26 (1963). This promise to pay may be enforceable on demand or at a given time. Section 3-104(1)(c), Ill. Ann. Stat., c. 26 (1963). Section 3-802, Ill. Ann.

Stat., c. 26 (1963), provides that the underlying obligation is not discharged by giving a note, but rather is suspended pro tanto until the instrument is due or, if it is payable on demand, until its presentment. There is accordingly no basis for equating a promissory note with a check.[18]

In sum, state law is consistent with the rule we urge in this case, *viz.,* that a promissory note issued by an employer does not constitute "payment" to an employee plan under Section 404(a) prior to its actual payment in cash or in property which is the equivalent of cash.

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[18] The commercial law of Pennsylvania applicable in *Sachs* (now codified in Section 3-121, Pa. Stat. Ann. (1970)) treats the demand note payable at a bank involved there as a check because the bank is required to pay the note upon presentment. See 1 Hawkland, *A Transactional Guide to the Uniform Commercial Code*, pp. 481–482 (1964). This rule has been adopted by the District of Columbia and 18 other states (Alaska, Connecticut, Delaware, Hawaii, Kentucky, Maine, Massachusetts, Missouri, Nevada, New Hampshire, New Jersey, New York, North Dakota, Ohio, Rhode Island, Texas, Vermont and Wyoming). The rule that a demand note payable at a bank is not equivalent to a check, has been adopted by 29 other states (Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, New Mexico, North Carolina, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Washington, West Virginia and Wisconsin). California applies this rule unless the bank is the drawee. In Virginia, however, the bank may at its option consider such a note as equivalent to a check. See 2 Anderson, *supra*, pp. 736–739; La. Stat. Ann., Rev. Stat., Section 10:3-121 (1976 Supp.).

But for federal tax purposes, a demand note payable at a bank under Pennsylvania law should not be treated as a deductible payment by the maker. In giving such a note, the maker does not intend an immediate outlay of assets, for he would otherwise have given a check.

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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SEPTEMBER 1976.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 404. DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OF ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN

(a) [as amended by Sec. 24, Technical Amendments Act of 1958, P.L. 85–866, 72 Stat. 1606] *General Rule.*—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income) but, if they satisfy the conditions of either of such sections, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

* * * * *

(3) *Stock bonus and profit-sharing trusts.*—

(A) *Limits on deductible contributions.*—In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a),

in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the stock bonus or profit-sharing plan. If in any taxable year there is paid into the trust, or a similar trust then in effect, amounts less than the amounts deductible under the preceding sentence, the excess, or if no amount is paid, amounts deductible, shall be carried forward and be deductible when paid in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any such succeeding taxable year shall not exceed 15 percent of the compensation otherwise paid or accrued during such succeeding taxable year to the beneficiaries under the plan. In addition, any amount paid into the trust in any taxable year in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this subparagraph shall not exceed 15 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the plan. The term "stock bonus or profit-sharing trust", as used in this subparagraph, shall not include any trust designed to provide benefits upon retirement and covering a period of years, if under the plan the amounts to be contributed by the employer can be determined actuarially as provided in paragraph (1). If the contributions

are made to 2 or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for purposes of applying the limitations in this subparagraph.

*　　*　　*　　*　　*

(6) *Taxpayers on accrual basis.*—For purposes of paragraphs (1), (2), and (3), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

*　　*　　*　　*　　*

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.404(a)-1 *Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; general rule.*

*　　*　　*　　*　　*

(c) Deductions under section 404(a) are generally allowable only for the year in which the contribution or compensation is paid, regardless of the fact that the taxpayer may make his returns on the accrual method of accounting. Exceptions are made in the case of overpayments as provided in paragraphs (1), (3), and (7) of section 404(a), and, as provided by section 404(a)(6), in the case of payments made by a taxpayer on the accrual method of accounting not later than the time

prescribed by law for filing the return for the taxable year of accrual (including extensions thereof). This latter provision is intended to permit a taxpayer on the accrual method to deduct such accrued contribution or compensation in the year of accrual, provided payment is actually made not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof), but this provision is not applicable unless, during the taxable year on account of which the contribution is made, the taxpayer incurs a liability to make the contribution, the amount of which is accruable under section 461 for such taxable year. See section 461 and the regulations thereunder. There is another exception in the case of certain taxpayers who are required to make additional contributions as a result of the Act of June 15, 1955 (Public Law 74, 84th Cong., 69 Stat. 134), and the regulations thereunder.

U.S. GOVERNMENT PRINTING OFFICE: 1976

FOR ARGUMENT

In The

Supreme Court of the United States

October Term, 1975

No. 75-1312

DON E. WILLIAMS COMPANY,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY BRIEF FOR DON E. WILLIAMS COMPANY

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PETITION FOR CERTIORARI FILED MARCH 13, 1976
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REPLY BRIEF FOR DON E. WILLIAMS COMPANY

STATEMENT

This appeal arises out of a complaint brought by the Petitioner, Don E. Williams Company, (hereinafter "Dewco") against the Respondent, Commissioner of Internal Revenue, (hereinafter "C.I.R."). In its complaint Petitioner asked

for a redetermination of the deficiency set forth by the C.I.R. in his Notice of Deficiency dated May 25, 1971.

The deficiency, which Petitioner feels is in error, as determined by the C.I.R. is in income tax as follows and results from disallowance of tax deductions.

Fiscal Year Ending	*Amount of Disallowance*	*Amount/Tax Assessed*
April 30, 1967	$31,589.32	$15,162.87
April 30, 1968	$ 2,743.94	$ 1,360.64
April 30, 1969	$ 1,004.60	$ 530.42

The commissioner erroneously determined for fiscal year ending April 30, 1967, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $31,589.32, and within the "grace period" allowed an accrual basis taxpayer by § 404(a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404(a) of the Internal Revenue Code of 1954.

The commissioner erroneously determined for fiscal year ending April 30, 1968, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of $33,333.26, within the "grace period" allowed an accrual basis taxpayer by § 404(a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404(a) of the Internal Revenue Code of 1954.

The commissioner erroneously determined for fiscal year ending April 30, 1969, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on de-

mand promissory note in the amount of $35,337.86, within the "grace period" allowed an accrual basis taxpayer by § 404(a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404(a) of the Internal Revenue Code of 1954.

The fact and exhibits were stipulated to by the parties and the case was submitted to the Tax Court of the United States.

Judgment was entered for the Respondent, with three judges dissenting, assessing deficiencies in income tax due from Petitioner as set forth above.

On appeal, the United States Court of Appeals for the Seventh Circuit affirmed, however, in doing so they declined to follow decisions of the Third, Ninth, and Tenth Circuits and also a district court decision in the Seventh Circuit.

ARGUMENT

I.

THE WORD "PAID" HAS THE SAME MEANING UNDER SECTION 404 AS IT HAS UNDER SECTION 267.

Respondent contends that the "paid" requirement of Section 404(a), Int. Rev. Code of 1954 (Section 23(p), Int. Rev. Code of 1939) (26 U.S.C.) should be interpreted differently than the "paid" requirement of Section 267(a), Int. Rev. Code of 1954 (Section 24(c), Int. Rev. Code of 1939) (26 U.S.C.). For more than twenty years Respondent has recognized that an accrual basis taxpayer satisfies the "paid" requirement of Section 267(a) by delivery of the taxpayer's promissory note. Rev. Rul. 55-608, 1955—2 Cum. Bull, 546, 548. However, Respondent asserts that delivery of its promissory note by an accrual basis taxpayer does not satisfy the "paid" requirement of Section 404(a). In support of his position of different interpretations of "paid", Respondent attempts to distinguish Sections 404(a) and 267(a). Petitioner respectfully submits that Respondent is in error for the following reasons:

First, Respondent ignores the great similarity which exists between Section 404(a) and 267(a). Both sections provide deductions for "trade or business expenses". The deductions under both sections would be allowable deductions under Section 162, Int. Rev. Code of 1954 (Section 23(a), Int. Rev. Code of 1939) (26 U.S.C.) were it not for their separate treatment under Sections 404(a) and 267 (a) respectively. Both Section 404(a) and Section 267(a) use the word "paid" rather than the words "paid or incurred" contained in Section 162. Summarizing, both Sections 404(a) and 267(a) evidence Congressional intent to treat certain "trade or business expenses" differently than they would otherwise be treated under the general "Trade or Business Expenses" section (Section 162) and both Sections 404(a) and 267(a) evidence Congressional intent to use the same methodology of differentiation in each Section by use of the single word "paid" rather than the words "paid or incurred". Clearly, a great similarity exists between Section 404(a) and Section 267(a) and no valid reason exists to distinguish them.

Second, in his effort to distinguish Section 404(a) and 267(a) Respondent contends that their respective histories evidence Congressional intent that the word "paid" should be interpreted differently under each section. Petitioner respectfully submits that in making such contention Respondent is clearly in error.

In enacting Section 267 and its predecessor Petitioner respectfully submits that Congress was attempting to "plug a tax loophole". Under Section 162 and its predecessor an accrual basis taxpayer takes the deduction for the "trade or business expense" when incurred and not when paid. However, the cash basis creditor of the accrual basis taxpayer does not report that expense as income until the cash is received, Sections 61 and 451, Int. Rev. Code of 1954 (26 U.S.C.). This dichotomy created no "tax loopholes" for taxpayers dealing at arms length with each other. Although the accrual basis taxpayer could deduct the expense when incurred, ultimately, the creditor must be paid and at that time the income must be reported. However, ingenious tax minds soon discovered that this dichotomy opened a fertile area for "tax loopholes" and "tax shelters" when the accrual basis taxpayer and cash

basis taxpayer were "related" as defined in Section 267 and its predecessor. It was possible to use this dichotomy among "related" taxpayers to enable the accrual basis taxpayer to take the deduction in the year of large income and the cash basis taxpayer to report the income in a year of small income. As submitted, it was to "plug this tax loophole" that motivated Congress to enact Section 267 and its predecessor.

The methodology used by Congress to "plug that tax loophole" evidenced in the enactment of Section 267 and its predecessor was to provide that when the taxpayers are related as defined in said Section the "trade or business expenses" otherwise deductible under Section 162 and its predecessor when "incurred" by an accrual basis taxpayer could only be deducted when "paid" by the accrual basis taxpayer. To alleviate the harshness of Section 267 and its predecessor upon accrual basis taxpayers, Congress did provide therein an additional period of two and one-half months beyond the taxable year in which the expense could be "paid" and still be claimed as an expense for that taxable year.

Subsequent to the enactment of the predecessor to Section 267, litigation arose as to the meaning of the word "paid" as used therein. In that litigation the Commissioner of Internal Revenue contended that "paid" meant "cash" and that the predecessor to Section 267 placed accrual basis taxpayers on the same basis as cash basis taxpayers when the taxpayers were "related" as therein defined. The Courts, other than the Tax Court, uniformly rejected the Commissioner's argument and held that an accrual basis taxpayer satisfies the "paid" requirement of said Section by the delivery of its promissory note. *Musselman Hub-Brake Co.* v. *Commissioner,* 139 F.2d 65 (C.A. 6, 1943); *Celina Manufacturing Company* v. *Commissioner,* 142 F.2d 449 (C.A. 6, 1944); *Anthony P. Miller, Inc.* v. *Commissioner,* 164 F.2d 268 (C.A. 3, 1947); *Mundet Cork Corporation* v. *Commissioner,* 173 F.2d 757 (C.A. 2, 1949). Thus, an accrual basis taxpayer satisfied the "paid" requirement of the predecessor to Section 267 by the delivery of its promissory note either within its taxable year or during the two and one-half month period beyond its taxable year.

Thus, Petitioner submits that when Congress re-enacted the predecessor to Section 267 into Section 267 under the Internal Revenue Code of 1954, it did so with full knowledge that the Courts, other than the Tax Court, had uniformly held that an accrual basis taxpayer satisfies the "paid" requirements of said Section and its predecessor by the delivery of its promissory note. It did so also with full knowledge that the Commissioner had consistently asserted a contrary position and was still asserting that position. Apparently in response to the rule of construction:

> . . . The re-enactment of a statute substantially unchanged is persuasive indication of adoption by Congress of a prior judicial construction thereof . . . *Commissioner* v. *F. G. Bonfils Trust et al.,* 115 F.2d 788, 792 (C.A. 10, 1940);

the Commissioner in 1955 acquiesced in those Court decisions and conceded that an accrual basis taxpayer satisfies the "paid" requirements of Section 267 by the delivery of its promissory note. Rev. Rul. 55-608, 1955-2 Cum. Bull. 546, 548.

In enacting Section 404 and its predecessor Petitioner respectfully submits that one of the substantial Congressional concerns was the "tax avoidance" which could be possible by virtue of the relationship existing between the payor and payee of the contributions under which that

Section are deductions to the payor taxpayer. See statement of Senator Brown, Senate Hearings Before the Committee on Finance on the Revenue Act of 1942, 77th Cong., 2d Sess. 455, 456 (1942). Under that Section the payor is the employer and the payee(s) are either the employees or a plan for the benefit of the employees. The relationship between employer and employee is frequently not a true "arms length" relationship. Many subtleties exist in that relationship which can provide a direct or indirect control in the employer quite similar to the "related taxpayer" control defined in Section 267 and its predecessor. Because of that similarity Congress quite naturally turned to Section 267 and its predecessor for the methodology to be used in the resolution of its concern.

Petitioner further submits that Congress used the same methodology to solve the problem under Section 404 and its predecessor as it did in solving the problem under Section 267 and its predecessor. It provided that the "trade or business expenses" defined in Section 404 and its predecessor and otherwise deductible under Section 162 and its predecessor when "incurred" by an accrual basis taxpayer could only be deducted when "paid" by the accrual basis taxpayer. Again, as it did under Section 267 and its predecessor, it provided an additional two and one-half months beyond the taxable year in which the expense could be "paid" by the accrual basis taxpayer and still be claimed as an expense for that taxable year.

As was the situation under the predecessor to Section 267, following the enactment of the predecessor to Section 404 litigation arose as to the meaning of "paid" as used therein. At that time the Commissioner was asserting that under the predecessor to Section 267 "paid" meant "cash". Because of the similarity between 267 and 404 and their

respective predecessors, quite naturally the Commissioner contended that under the predecessor to Section 404 the word "paid" meant "cash" just as he was contending it did under the predecessor to Section 267. *Sachs* v. *Commissioner*, 11 T.C.M. 882, Reversed 208 F.2d 313 (1953); *Slaymaker Lock Co.* v. *Commissioner*, 18 T.C. 1001, Reversed Sub. nom in *Sachs* v. *Commissioner*, 208 F.2d 313 (1953); *Logan Engineering Co.* v. *Commissioner*, 12 T.C. 860. As was the case under the predecessor to Section 267, the Commissioner's argument was judicially rejected other than by the Tax Court. The Third Circuit Court in *Sachs* v. *Commissioner, supra,* held that an accrual basis taxpayer satisfies the "paid" requirement of the predecessor to Section 404 by the delivery of its promissory note.

Thus, for many years prior to 1955 the Commissioner contended that the word "paid" as used in both Sections 267 and 404 and their respective predecessors had the same meaning and meant "cash". Petitioner submits that in doing so the Commissioner recognized that the same methodology was used by Congress under both Sections. As previously stated, in 1955 the Commissioner issued Rev. Rul. 55-608, 1955-2 Cum. Bull. 546, 548, and conceded that an accrual basis taxpayer satisfies the "paid" requirements of Section 267 by the delivery of its promissory note. However, in spite of his long standing position that the word "paid" had the same meaning under both Sections, the Commissioner failed to acquiesce in the *Sachs* decision similarly construing the word "paid" under Section 404; and, thus, from the time of the issuance of Rev. Rul. 55-608, 1955-2 Cum. Bull. 546, 548, it became necessary for the Commissioner to contend, as he does in this case, that the word "paid" has a different meaning under Section 404 than he concedes it has under Section 267.

As was the case with Section 267, Congress re-enacted the predecessor to Section 404 into Section 404 under the Internal Revenue Code of 1954. It did so with full knowledge that the Third Circuit Court in *Sachs* v. *Commissioner, supra,* had held that an accrual basis taxpayer satisfied the "paid" requirements of Section 404 by the delivery of its promissory note. It did so also with full knowledge that the Commissioner had consistently asserted a contrary position and was still asserting that position. Accordingly, Petitioner respectfully submits that under the rule of construction enunciated in *Commissioner* v. *F. G. Bonfils Trust et al., supra,* in re-enacting the predecessor to Section 404 into Section 404 substantially unchanged, Congress can be presumed to have adopted the judicial interpretation of the word "paid" under said Section as set forth in the *Sachs* v. *Commissioner, supra,* case. Nevertheless, as stated, the Commissioner inexplicably failed to acquiesce as he did under Section 267.

Further, as stated in Petitioner's Brief and as conceded by Respondent, since the enactment of Section 2003(a) of the Employment Retirement Income Security Act of 1974 (ERISA) Pub. L. 93-406, 88 Stat. 971, the paying of a contribution to the Trust under Section 404(a), Int. Rev. Code of 1954 (26 U.S.C.) with a promissory note is a prohibited transaction. Thus, the subject issue before this Court will have no prospective meaning after the effective date of ERISA, September 2, 1974. Respondent contends that in enacting ERISA and therein prohibiting the funding of the employees' plan with employers' debt obligations Congress was merely reaffirming the intent of Congress many years earlier that the delivery of a note by an accrual basis taxpayer does not satisfy the "paid" requirement of Section 404(a) and its predecessor, Respondent's

Brief, page 25. Petitioner submits that such contention clearly does not comport with the legislative history of ERISA. Further, as previously stated, such contention does not comport with the legislative history of Section 404(a) and its predecessor.

The legislative history of ERISA clearly shows Congressional awareness of "reality" as it existed in 1974. That "reality" was that for many years employers had been borrowing from the employees' plan and evidencing such loan with their debt obligation all in conformity with existing law prior to ERISA. That "reality" was that for many years accrual basis taxpayers had been funding the employees' plan with their debt obligation and that the Courts, other than the Tax Court, had consistently held that the delivery of such note(s) satisfied the "paid" requirements of Section 404(a). This Congressional awareness of "reality" is clearly shown in the pertinent Committee Report on ERISA wherein Congress stated (H.R. Conf. Rep. No. 93-1280, 93d Cong., 2d Sess. 469 (1974)):

> It is intended that prohibited loans include the acquisition by the plan of a debt instrument (such as a bond or note) which is an obligation of a party-in-interest. * * * Similarly, it is intended that it would be a prohibited transaction (in effect a loan by the plant to the employer) if the employer funds his contributions to the plan with his own debt obligations.

Thus, in enacting ERISA Congress clearly showed its awareness and intent to therein prohibit certain transactions which prior to its enactment were proper and legal.

Summarizing, Petitioner respectfully submits that the respective histories of Sections 267 and 404 more reasonably support that the word "paid" has the same meaning under both Sections and does not mean "cash" as Re-

spondent contends Section 404 does and as Respondent contended Section 267 did prior to his acquiescence in 1955. Rather, the respective histories of both Sections support the Congressional intent that the word "paid" means the "transfer of something of value" rather than a mere bookkeeping entry as is permitted under Section 162, Certainly, the delivery of the taxpayer's note to the Trust is the "transfer of something of value". The issue is what is the value of that note. (In this case the Respondent has stipulated that the value of the notes equaled the amount of the claimed deduction by Petitioner.) For years the Commissioner has been engaged in valuing assets such as closely held corporate stock for tax purposes and to require him to value the asset transferred under Section 404 places no inordinate burden upon him.

Third, Respondent attempts to distinguish Sections 267 and 404 by contending that an alleged "tax symmetry" exists under Section 267 which does not exist under Section 404. Respondent suggests that under Section 267 when an accrual basis taxpayer delivers its note to its related cash basis payee there is no need to bar the deduction since the payee must include the corresponding amount in his gross income. Respondent's Brief, p. 28. This is the "tax symmetry" which Respondent alleges exists under Section 267 and not under Section 404. In so contending Respondent is in error as the same alleged "tax symmetry" exists under Section 404. When an accrual basis taxpayer delivers its note to the Trust under Section 404 there is no need to bar the deduction as the payee Trust must include the corresponding amount in its gross income and so report it in its annual information reports to the Internal Revenue Service. Section 6047, Int. Rev. Code of 1954 (26 U.S.C.). Clearly, whatever "tax symmetry" exists under Section 267 also exists under Section 404.

Fourth, Respondent further attempts to distinguish Sections 267 and 404 by stating that the payee under Section 404 is tax exempt thereby inferring that the payee under Section 267 is not tax exempt. In so contending Respondent ignores the express wording of Section 267. Section 267(b)(9) specifically refers to certain educational and charitable tax exempt organizations which are related to the payor taxpayer as therein defined. Clearly, Section 267 applies to both related taxable and tax exempt payees and no distinction can be made between Sections 267 and 404 on that basis. Further, assuming *arguendo* that such distinction was valid, Petitioner respectfully submits that such distinction is artificial and ignores great similarity between those Sections and the identical methodology used by Congress under both Sections.

Fifth, Respondent suggests that an analogy exists between Section 404 and Section 170 of the Int. Rev. Code of 1954 (26 U.S.C.). Respondent's Brief, pp. 22 and 29. However, Respondent cites no authority under Section 170 for treating accrual basis taxpayer's notes in the manner it contends that accrual basis taxpayer's notes should be treated under Section 404. Further, in so contending, Respondent again ignores the great similarity between Sections 267 and 404 and the dissimilarity between Sections 404 and 170. As previously stated, both Sections 267 and 404 provide deductions for "trade or business expenses" which are "paid" and which otherwise would be allowable deductions under Section 162 if "paid or incurred". However, Section 170 provides deductions for charitable contributions which are expressly excluded as "trade or business expenses" under Section 162. Thus, charitable contributions are clearly not "trade or business" expenses under Section 162 and would not be allowable deductions

were it not for the express enactment of Section 170. Summarizing, Petitioner submits that no analogy exists between Sections 404 and 170 and further, assuming *arguendo* that such an analogy exists, no precedent is cited under Section 170 for treating accrual basis taxpayer's notes as Respondent contends Petitioner's notes should be treated under Section 404.

II.

THE UNIFORM COMMERCIAL CODE DOES NOT SUPPORT THE RESPONDENT'S THEORY.

Respondent attempts to support its position by a misconstruction of the Uniform Commercial Code as adopted in Illinois. *Ill.Rev.Stat.* 1963, Ch. 26. The Respondent suggests that the pro-tanto suspension of a debt by the giving of a note does not also apply to a check. Respondent's Brief, pp. 30 and 31. This implication is at best misleading and is clearly contrary to the express wording of *Ill.Rev. Stat.* 1963, Ch. 26, §§3-104, 3-802. 3 Anderson, *Uniform Commercial Code*, pp. 141-142 (2d Ed. 1971).

Section 3-104 of the Illinois version of the Uniform Commercial Code defines both checks and negotiable notes as negotiable instruments. *Ill.Rev.Stat.* 1963, Ch. 26, §3-104. As negotiable instruments both a check and a demand note will discharge the underlying debt pro-tanto until the time of presentment. *Ill.Rev.Stat.* 1963, Ch. 26, §3-802. Respondent states that the pro-tanto suspension of the debt applies to notes but then fails to indicate that the suspension also applies to checks. *Cf.* 3 Anderson, *Uniform Commercial Code*, p. 142 (2d Ed. 1971). After their failure to reveal the similarity between checks and notes the Respondent proceeds to the unwarranted conclusion that demand notes and

checks are totally dissimilar for purposes of satisfying an employer's debt to an employee trust under Section 404(a). Int. Rev. Code of 1954 (26 U.S.C.). As the Illinois version of the Uniform Commercial Code treats both checks and notes the same, with regard to their effect upon the underlying debt, the Respondent's reliance upon the Uniform Commercial Code is erroneous and misplaced.

CONCLUSION

For the reasons stated in Petitioner's Briefs, the judgment of the Court of Appeals below should be reversed and an order entered allowing the deductions for contributions to the Profit Sharing Plan and disallowing any assessment of deficiencies for the taxable years ended April 30, 1967, April 30, 1968 and April 30, 1969.

Respectfully submitted,

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